EMPLOYMENT AND INVESTMENT INCENTIVES FOR SMALL BUSINESS IN DISTRESSED AREAS

HEARING

BEFORE THE

SUBCOMMITTEE ON TAX, ACCESS TO EQUITY CAPITAL AND BUSINESS OPPORTUNITIES

OF THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

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WEDNESDAY, APRIL 27, 1983

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON TAX, ACCESS TO EQUITY
CAPITAL AND BUSINESS OPPORTUNITIES,
Washington, D.C.

The subcommittee met pursuant to notice, at 9:30 a.m., in room 2359-A, Rayburn House Office Building, Hon. Henry J. Nowak (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN NOWAK

Mr. NOWAK. The subcommittee will come to order. We will read the opening statement and then get right to our expert witnesses who are here today.

Today's hearing will focus on the displaced worker problem and the need to implement a comprehensive program to provide economic incentives for the Nation's distressed areas.

This country is currently undergoing a major structural change that is marked by increased automation and decline of our heavy industrial base. As a result of this structural transformation, many Americans have either been laid off or face imminent layoff through no fault of their own and are increasingly experiencing difficulties in matching their present skills with existing employment opportunities.

The magnitude of the problem is illustrated by a recent Congressional Budget Office study. Applying different definitions for dislocated workers, the CBO study claims that the number of dislocated workers could rise as high as 2.2 million or 20 percent of all unemployed workers in 1983.

Another pressing problem facing the Nation, which is at least partially attributable to the underlying structural changes in the economy and the decline in our industrial base, is the deteriorating economic strength of many older urban areas.

The administration has responded to this dilemma by proposing an urban policy strategy which is patterned after the so-called "enterprise zone" concept. While it is important that the administration recognizes the need to provide some economic stimulation to this country's urban centers, it is imperative that we realize that proposals which attempt to encourage business expansion in distressed areas merely by providing tax and regulatory relief are too narrow in focus.

Since the administration is pursuing a policy of cutting overt Federal programs, tax incentives by necessity become an important tool to enhance business internal capital formation.

Indeed, as chairman of this subcommittee, I have long been a proponent of tax relief measures as a means to alleviate the cash flow problems of our small business community, although I maintain that tax incentives alone will not cure our urban ills.

What is needed, therefore, is a well-balanced plan which combines tax and regulatory relief with a variety of economic and business development incentives. For example, startup and early stage development firms will derive no benefit from tax breaks when as a general rule, they experience little or no profitability in their first several years of operation.

Therefore, an essential component in any meaningful plan to encourage newly formed and growing small firms to locate and expand in distressed areas, is a measure to provide up-front moneys for seed and working capital. In addition, to foster the infusion of needed capital into all firms operating in declining areas, it is important to provide investor incentives both for individuals and organized venture capitalists.

As a further stimulus to attract business investment and expansion in designated areas, a viable program must include provisions designed to maintain and improve the rapidly decaying infrastructure of areas suffering from long-term economic deterioration. In order to encourage entrepreneurs to locate and remain in the area, they must be assured of a healthy commercial environment which necessitates a sound infrastructure base.

In conclusion, we must strive to create an awareness in the Congress that any plan to revitalize our Nation's distressed areas must be comprehensive in nature. In addition to tax and regulatory relief, therefore, a well-balanced plan should concentrate on implementing provisions designed to enhance the external capital formation needs of the business community to maintain and improve the local infrastructure base, to utilize past proven economic development tools and to develop a training and job creation strategy for our Nation's displaced workers.

I want to welcome one of our colleagues who has been instrumental in developing and was a sponsor of the original legislation termed enterprise zone, a colleague of mine contiguous to me in my district in Buffalo who has taken a great deal of time and effort to look at all problems, whether they exist in his district or in the State or in fact in the Nation. We certainly want to welcome to the table the Honorable Jack Kemp who has participated in this discussion, in fact has led it, and certainly has been the catalyst for the Reagan administration's interest in the enterprise zone concept. I want to welcome our friend and colleague, Jack Kemp.

TESTIMONY OF HON. JACK KEMP, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. KEMP. Thank you, Mr. Chairman. I appreciate the kind words and I appreciate your holding hearings on this subject, particularly because you come from one of those cities in the Northeast which faces the problems that many other cities face but at an

exacerbated level and a compounded rate. Buffalo is typical in the Northeast of industrial cities going through rapid change and finding themselves in the dilemma of not having a job creation climate that is vast enough to absorb the changes that are taking place.

I testified last week or submitted testimony before the Senate Finance Committee, Mr. Chairman. My testimony today at least pro forma would be the same, so I would just like to submit that testimony for the record and kind of talk about some of the points that you made and try to put in perspective what I think the purpose of the enterprise zone legislation is and——

Mr. NOWAK. Without objection, that full testimony will be made a part of the record.

Mr. KEMP [continuing]. Maybe answer some questions and engage in some dialog. If you could just make sure that everybody has one before the Nowak committee and not the Senate Finance Committee.

Once again thanks for your committee's interest in this legislation. It is controversial; I think unduly so. And of course this whole economic climate in which we find ourselves today is controversial. The theory behind the enterprise zone concept is that people respond to rewards. And it sounds overly simple, but I think it has a profound implication for the inner cities. People respond to rewards, whether they are in the inner city or in other parts of the country. Irrespective of geography, color, ethnicity, geography or demographic difference, people respond to rewards.

In 1975, in Brazil, the government wanted to get people to move and begin to repopulate the Amazon and they established an enterprise zone. They didn't call it enterprise zone, they called it a trade zone. But it was a zone for small, light manufacturing and exports to move into the Amazon River area called Manaus. And 1,300 little businesses moved 3,000 miles up the Amazon to respond to the opportunity that was given to them by the Brazilian Government to form small manufacturing export oriented companies and now there are 3,700 new jobs in Manaus, Brazil, 3,000 miles up the Amazon River.

In Dublin, Ireland, several years ago, they abolished the income tax on artists. They wanted to establish a climate for artists in painting, people to write books and plays and compose music. An unbelievable renaissance has occurred in the last 4 years in Ireland because people responded to the reward.

The enterprise zone is not just cutting taxes or regulations, it is trying to say that here is a place in our country that needs compensatory assistance. As you mentioned, Mr. Chairman, something has to be done even in the face of a recovery, and we can debate how well it is going—I am not smug about it, but I think there are obvious signs of national recovery. They are not fast enough for me, and they are certainly not fast enough for you and others on this panel because all of us represent in one way or another areas that are desperately in need of new jobs.

In Puerto Rico in the 1950's and 1960's, Luis Muñoz Marin was instrumental in helping create on the Island of Puerto Rico legislation with the help of the U.S. Congress and the U. S. Government's incredible incentives for manufacturers and businesses to move to Puerto Rico.

Unfortunately, it was simply predicated upon the idea of trying to change one location of a firm to another. It worked because they literally, almost abolished the tax on manufacturing certain goods in Puerto Rico. It did create jobs, but it was kind of a zero sum approach.

So the purpose of enterprise zone seems to me should not be to try to get jobs away from the suburbs or away from the sunbelt, or away from this area or that area in a giant zero sum game, it should be to establish a climate for entrepreneurship to create new businesses and therein lies the real key to this bill.

Most new jobs come from small startup business. Labor intensive businesses. David Birch at MIT, as you have heard and we have all talked about for many years, has studied at MIT and says that 95 percent of all new jobs in the Northeast come from small businesses with less than 100 employees. So if you really want to create a climate for full employment in this country, we need to have lots of men and women, irrespective of their differences or their color or their demographics, wanting to go into business. They are not all going to succeed. I think that has to be made clear. This is one reason why, Mr. Chairman, I had a little trouble with the idea that the Government should finance the startup capital. My feeling about that, if you don't mind me beginning—not to be controversial, but just to kind of engage the committee in a dialog—is that if the Government decides which businesses are going to get the startup capital, it then has a hand in the choosing of that business and if it has a hand in choosing the business, unfortunately it is again taking money or credit or capital or seed corn away from someone else.

I would much rather see us, Mr. Chairman, work out some amendment to the enterprise zone legislation that you have introduced, and others have introduced, or that I have introduced or President Reagan has introduced, that would encourage venture capital to be targeted in as market oriented a way as possible, toward those businesses that want to start up and want to do business in the designated areas.

Charlie Rangel, a member of the Ways and Means Committee, a distinguished Member of Congress and one of the leaders of the Black Caucus, is working on a piece of legislation which would amend the concept of enterprise zones to provide for a 50-percent deduction for an investment in a debenture or a stock purchase for an enterprise zone.

It is not perfect, but it's a start; I'd go 100 percent. But that is a little bit too radical for some. The fact is, we should do something to try to use the market as a way of encouraging people to invest in those enterprises that choose the inner city.

Earlier, I was mentioning some places in the world where this has been tried and where it is at least modestly working. I mentioned Brazil, and Puerto Rico, another example is Sri Lanka. This tiny, yet democratic country on the continent of India has established an enterprise zone in the capital city of Columbo. They used tax incentives and regulatory incentives and it is working. Seventeen hundred new businesses have been created in the last 5 years. Now, some of them are very small but again, that is the labor intensity of the concept.

England, on the other hand, Mr. Chairman, decided to form enterprise zones and they took the concept and they established it outside the area in which the people were located. What they tried to do was take people from one area to another area simply by abolishing regulatory codes that infringed upon businesses and industries. That isn't the purpose of enterprise zones. Certainly you and I as residents of western New York, my friend from Youngstown, all of us, can't say that we are going to pick up the residents of depressed areas of the country and move them to Tennessee or to move them to the sunbelt. I think we have got to target the assistance and target the incentives to those areas of the country that are in desperate need of help.

Our bill reduces but does not abandon regulations. We are not suggesting that regulations are not important from civil rights to the environment to safety and health. We want to protect the climate. Even the minimum wage is not dealt with even though that has been an attack on the enterprise zone. We recognized right off that if this thing was to work, Mr. Chairman, it had to be a Nowak and a Kemp, it had to be the Black Caucus and the Hispanic Caucus, it had to be conservative and liberal and Republican and Democrat, because you can't have a bill go through this Congress as controversial or as far-reaching as enterprise zones and not have people who are willing to rise above their party and really, some of those differences sometimes divide us.

So I think one of the nice things about this bill has been that it has united people like Bobby Garcia, from the South Bronx, and Bill Gray from Philly, and you from Buffalo, conceptually speaking, and myself, and Trent Lott from Mississippi. It is an interesting concept. And from that standpoint I would hope that as we move forward, we keep the thrust in the direction of not turning it either to the far right or to the far left. That we keep it down the middle, and that we rely upon incentives and rewards.

The third thing that I would like to address is the fact that enterprise zones do not and should not replace existing infrastructure spending in the inner city. I don't favor community development block grant reductions. I think UDAG has a place, EDA has a place, I don't think they are perfect, but I don't think they should be wiped off the books. Just as in 1983, Congress is going to find a place for those programs from housing to inner city education to vocational education as categorical grant programs to UDAG and EDA and CDBG and revenue sharing. I think we have to use every existing program to make this country, particularly those areas that are hard pressed, better able to deal with these pressing problems.

One other point that I would like to make, Mr. Chairman, is this question about timing. It seems to me that the hour is late. I can't understand why Congress has failed to move in this direction. People say, well, we are coming out of the recession, you don't need to worry about it. But even if the economy were totally out of the recession, we are faced with the structural problems of declining industrial base of the northeast. I want to say as one member of the northeast, it is important for us to recognize that these structural problems, I think, are being overplayed and overdramatized.

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The best thing you can do for steel and autos is to get interest rates down.

I don't believe that this country has moved from an industrial smokestack base to one of high technology and silicone chips in the space of just 2 years. Because there aren't enough high technology jobs. I saw where Atari is moving to Japan, laying off 500 workers in the silicone valley of California. The problem goes beyond just choosing high tech over industry. I think industry is essential to the defense of this country. I think it is essential to the blue-collar jobs upon which we have relied in the past. I think it is essential to our whole economy and I recognize that there are problems and that we are changing technology. Today autos are not built with as much steel as they used to be. We drink Coca Cola from aluminum cans, instead of steel cans. AT&T is going to build a transmission belt for telephone calls from Boston to Richmond, Va., with fiberoptics and not copper, and that is going to save 2 million pounds of copper. This has been going on for 200 years; that is what the industrial revolution is all about. People were pushing technology over the cliff back in the 18th century because they were afraid it would destroy jobs.

Electronics and computers and communications and technology are going to create jobs, but what I am suggesting, Mr. Chairman, is that I think we are going to enter and we should facilitate the entrance of an era in which technology can be applied to producing autos and steel and machine tools and I really, strongly believe that it is too early to give up on the industrial base of the northeast. It is too early to give up on steel and autos and machine tools and I think we should also, as we discuss these pieces of legislation, not buy the theory of some economists, some on the left and unfortunately some on the right who are saying that we are going to put everybody to work in computers and electronics or semiconductors as a solution to the job problems of the northeast.

I don't think it is going to happen, so your effort to focus attention on incentives and capital and new jobs, Mr. Chairman, is deeply appreciated. I am a Republican and you are a Democrat; I'm from the suburbs, you are from the city. But I want to tell you that anything that you and I can do to help Buffalo, to help the northeast, to help the other areas of this country, I think has to be done and should have been done yesterday.

I apologize for the length of my remarks, but I did want to clear up some of what I consider to be misunderstandings about the bill.

[Congressman Kemp's prepared statement follows:]

PREPARED STATEMENT OF HON. JACK KEMP, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman and members of the committee, I want to thank you for giving me this opportunity to testify on behalf of the Enterprise Zone Act of 1983 , which Representatives Conable, Garcia and I have introduced in the House of Representatives as H.R 1955.

Let me say how pleased I am that the idea of providing incentives to create jobs and revitalize our depressed areas through creating an open, free-market environment has gained such strong support. To quote Tom Bethell, " An economy is precisely kept in a dynamic state by two powerful forces: the push (from the bottom) of those escaping poverty, and the upward pull or the magnetic attracion of wealth." This is precisely the rationale behind the Enterprise Zone concept -- to restore incentives for that "push" and "pull".

Over the last three years the coalition for enterprise zones has grown, and is continuing to grow with the concept being endorsed by one organization after another. The National Urban League, the NAACP, the League of Cities, the National Urban Coalition and members of the Congressional Black Caucus have all endorsed the concept of enterprise zones. Both the Republican and Democratic platforms urged that this idea be explored back in the summer of 1980. Mayors accross the Nation have applauded this iniative, and enterprise zone committes, conferences and task forces have been springing up over the past several years.State legislatures have debated and many have passed enter-

prise zone legislation. And now, President Reagan has committed his administration to establishing enterprise zones in the Nation's poorest urban and rural communities.

The enthusiasm reflect, in large part, the frustration we can see with the wasteland of ideas for helping cities. The key behind the enterprise zone concept is that poor people are not some special helpless class. Despite their predicament, the poor have the same goals and aspirations as other Americans. They want to be productive and self-sufficient in providing for their families. They want jobs, they want to be able to save and invest. But they need tangible economic opportunities, which are now missing from our inner cities and many of our rural areas.

We must unleash the productive capability that exists in the minds, hands and creativity of the people. People will take a chance on a better future, they will invest their human capital, if they believe they have some chance to succeed. This is true of the poor and it is true of the entrepreneur as well.

A principal aim of enterprise zones is to overcome barriers to the expansion and formation of the young or new small businesses which create most jobs. One of the highest of these barriers is the scarcity and high cost of financing, especially the risk capital which will be required for successful growth in enterprise zones.

Future-oriented tax incentives make more capital available in the present. By reducing capital gains and income taxes, in particular, the Enterprise Zone Act of 1983 promises a greater reward to those who succeed in their initial risk-taking investment. In this way we tap the greatest resources available -- the huge pool of private resources

seeking a significant, after-tax rate of return in these uncertain times.

Growing small businesses account for most net new jobs and a disproportionate share of economic growth. What these vital small businessees need most is start-up venture capital. The vast majority of it comes from personal savings of the entrepreneur, followed by individual investors. Lowering the tax on small business income only helps the business after it begins to make a profit, which may not happen for a few years.

The elimination of taxation of capital gains derived from investments in the zone is important, but it is not sufficient to generate the needed investment. Further, tax credits are of no help when there is no tax against which to apply the credit, this is the probable case in the early, starting-up years of a small business. What is needed is a means by which current year risk taking will be rewarded with current year tax savings -- or "equity expensing".

Such an arrangement would enable investors to deduct immediately (up to some limit) the cost of purchasing enterprise zone stock or debentures. By offering an immediate tax advantage it would help attract upfront capital, and significantly improve its rate of return.

While I stand in full support of this legislation, I would strongly recommend adding an expensing provision to attract additional capital to enterprise zones.

The Department of Housing and Urban Development's enterprise zone selection process will be highly competitive. The primary criteria for choosing which proposed zones will receive Federal designation will be the quality and strength of the incentives to be contributed by the State and local governments.

A number of cities are known nationally for their existing commitment to urban revitalization. With or without Federal assistance, with or without aid from business, they have already made the maximum effort by providing substantial resources for zone-eligible areas. Yet the way the Act is structured, such past commitments are not given a high degree of importance in the zone selection process. I feel that it is important that the selection process recognize applicants that have a successful record of significant past efforts. I would strongly support an amendment that would provide for the inclusion of granting credit for past activities in the selection process.

I am pleased that this legislation provides for a 5% employee nonrefundable tax credit. I felt last year, when this committee dropped this particular element from the package of economic incentives, that the bill was severely weakened.

We must remember that, etween giving up welfare benefits and paying taxes, the poor, who want to stay off welfare face what are, effectively, the very highest marginal tax rates of all. Retention of the employee tax credit reduce the tax rate faced by individuals leaving welfare for work, and will also provide an important incentive for skilled workers and managers to take jobs in the enterprise zone areas. When it comes to his or her own personal welfare, every person is an entrepreneur. Everyone makes economic calculations. A person, today, who gives up welfare or unemployment benefits to take a job that provides scarcely more, if any, in after-tax income than the public assistance benefits provide is just not being realistic. But that is exactly what we ask of our poor. I feel that it is vitally important that this element of the economic incentives package be

retained.

I am pleased, in closing, to say that I am glad to see the extent of support of enterprise zones exhibited here today and am proud to have been involved in the process that has brought this important piece of legislation so close to being a reality. I hope that it moves swiftly, because I do not believe that the country can wait. Our economic recovery has begun -- but we must also reach out further and target those areas of the country, urban or rural, that are worst off. We must all move ahead and we cannot leave anyone behind.

The concept of enterprise zones has been a long time coming and I, as an original supporter of this idea, am dedicated to helping perfect the bill and enacting it into law. It is a vital measure to bring hope to the disadvantaged, the poor and the unemployed and to let them know that we have not forgotten our goal of justice, opportunity and prosperity for all.

Mr. NOWAK. Thank you very much. I think it is refreshing to see someone who has given this subject the depth of thought you have, who has participated in the debate, and in the past has been flexible and willing to move together with the diversity of this Congress. It has been helpful in trying to establish a means whereby we can bring about a broad incentive with different specifics. This controversial discussion started off with great division, and I think that in a great measure it is due to your broadness that we have moved from that division to many areas of common ground.

Mr. KEMP. If you will allow me to say, I apologize for interfering, but 14 States have already passed enterprise zones. Connecticut, Chris' New Jersey passed one——

Mr. SMITH. We're waiting upon you.

Mr. KEMP [continuing]. New York is about ready; Governor Deukmejian of California and Mayor Bradley, his opponent, a black mayor of one of the largest cities in the world, are both cosponsors, at least conceptually, of the enterprise zones for California.

Indiana has passed it, so it seems to me late, Mr. Chairman, and your hearings I think are going to have an impact. I appreciate them.

Mr. NOWAK. We hope to take this record and distribute it to every member of the Ways and Means Committee and others because I think it is a vital response for the structural problems that are out there and the general kinds of market demands that aren't picking up fast enough which would be greatly helped by this new incentive. I want to make a couple of comments on some of the specifics in the bill.

One of the titles we do have, as you have mentioned, is a deduction of $20,000 for an individual investor who purchased stock in a small business—$40,000 if the return is joint—so it would give that other incentive from the private investor. But there has been much discussion and many of our mostly liberal friends have suggested that we need some type of funding. What I have tried to do is combine the SBA funding that is already out there.

We also have the Economic Development Administration. If we are going to use it, why not make it a part of this bill and make it have more impact? And this would be included, of course, in addition to the tax incentives we are talking about.

Another provision that we have put in here is some direct expensing.

Mr. KEMP. I agree with you, Mr. Chairman.

Mr. NOWAK. I think that is a very important key for that initial capital formation.

Mr. KEMP. Let me make a comment. I would agree with expensing and I would agree with the ability to deduct a certain amount of income from taxation if it is invested in an inner city enterprise.

I guess I wouldn't vote against the bill, if we started targeting SBA, but I would hope that there would be at least one bill in this country, one piece of legislation designed to encourage capital formation, investment, and entrepreneurship in the inner city that didn't rely on some of the subsidy programs that we have had in the past. SBA has been working in Buffalo to a certain extent, but it is not an answer to the problems of small business. You have 13 million small businesses in this country. Unfortunately SBA is

picking and choosing; they are fallible human beings. I hate to think that the only way we can establish an increase in small business enterprise in this country is by having the Federal Government tax one entity and then redistribute it to another entity.

So from my standpoint, Mr. Chairman, I would make the philosophical point that it would be nice to just have one bill that was really aiming toward a market approach and using whatever incentive you can find. Second, Mr. Chairman, most new businesses don't start up with Federal money. Most new businesses do not start up with any government money. They start up from savings and venture capital and one good thing—despite all the bad news today—the one good thing is that we have an equity market that finally is beginning to rise. It is over 1200 for the first time. I hope it is 1600 by the end of the second quarter. Interest rates are beginning to come down. Venture capital up over 50 percent in just one year is at an alltime high in terms of normal as well as real terms. The last point I would make refers David Birch's study at MIT that says that 90 percent of all the new capital coming into new businesses comes from personal savings, not just personal from the individual entrepreneur, but that of his friends and his family. Many of our black colleagues and minority colleagues have said they don't have access to the same savings rates. Well, that is the purpose of the Rangel amendment: to target savings which are rising, for instance, from 4.9 percent in 1979 to 7.1 percent here in 1983. The rise in savings, the rise in venture capital is going to encourage, I believe, more capital invested in an enterprise zone if we target the expensing for that investment by using the Rangel amendment.

So while I would much rather go the Rangel amendment way instead of SBA, I recognize, Mr. Chairman, that we should use every available existing government program in such a way as to compensate for this high unemployment among blacks and teenagers and inner city residents.

Mr. NOWAK. We have taken steps in the last few years to increase savings. I was at a hearing yesterday for several hours where one of our Mayors was talking about the problem they are having selling municipal bonds now. And what he thinks is the crowding out of his municipal bond market by the Government. By the Government, he meant the availability of the new tax deductible investments such as the Keogh and the IRA's. They attribute two or three points in increased costs just to that and we have really cut down, or at least held static, overt Federal spending.

So the only thing that I think we can do is use the existing programs at the present levels, along with tax incentives. Because either it is going to be an overt program to get somebody into business, or it is going to be the incentive of tax—either deductions or expensing—to bring that person into a position where it is desirable and he has the willingness to take that up-front risk.

Mr. KEMP. Everybody takes a gamble when they first start a business. What a bank is looking for, what an investor is looking for, what a potential investor is looking for is to see what is the profit potential of that business. If we dramatically lower the tax on future profits, then in effect you are encouraging people to invest in those ideas that have a chance.

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But if you have a good idea and you go out and invest in it, and then the Government taxes away your profit or depreciates it by terrible bouts of inflation at double digit levels, in effect you do as much damage to that business as if you advised that individual not to go into business in the first place.

Mr. NOWAK. As you mentioned, I think we also need to look at the high interest rate structure that we have been living with. And also consider the problem of the deregulation of the financial markets in moving the cost of money from the regulated rate of 5.25 to a floating rate or competitive quote rate of 9 percent. Today in the paper you can invest at 10.25 percent and unless you have a small business where you are going to do a little better than that, it seems to me that an awful lot of people are going to be taking the high interest rate route and forgetting about taking the risk, taking the innovative struggle to start a small business.

Mr. KEMP. I agree with you.

Mr. NOWAK. If that is in competition with you.

Mr. KEMP. Getting interest rates down is the sine qua non of economic policy right now for all of us.

Why not totally expense an investment in modernizing a steel or an auto factory? Up until 2 years you couldn't recover the cost of the capital until 11 years or 16 years in some cases. England has expensing. Japan has expensing. Every industrial country that we are competing with in the world has expensing except the United States of America. And you bring it up and somebody says well, that's trickle down economics. I'll tell you what is trickle down. It is the unemployment and the tragedy that is occurring in this country. I think we have to do everything possible to get steel and autos and manufacturing back on their feet. And that means lower interest rates and a better tax climate.

Mr. NOWAK. Thank you very much. I appreciate your remarks.

Mr. Williams from Ohio.

Mr. WILLIAMS. I appreciate the gentleman's remarks. He has visited my district and certainly is a fighter for change and has been and continues to be.

I just have one question. As I think everyone knows, I agree that cuts can help an existing business with tax incentives and so forth. I am still deeply concerned about how we help new businesses, especially dealing with the reluctance of the banking community. Or the inability, maybe, is the better way to put it, of the banking community to provide reasonable rates or prime rates for a new venture in the small business community. So maybe the only question I would have is if you still agree that there is a reluctance, do you think we are doing enough. I am sure the answer to that is no, but how do we best deal with the reluctance of banks to help new ventures, especially in an area like mine, where the future looks somewhat dim for a potential investor. The climate is not there, and it is difficult, first of all, to get investors interested and when you do, to have them walk into a local banking institution and that further discourages them. So maybe you could comment on that.

Mr. KEMP. Well, heretofore if you look at inner cities in the country, many of them have been red-lined de facto. You know, there is someone sitting up in the board room looking at a map and he says this is an area where the risk is too high, and we are not

going to put money in that and it has been red-lined. And we all know it happened and for different reasons too numerous to mention, there was prejudice against those areas, and in effect an enterprise zone, I would say to my friend from Ohio, is an attempt to change that line from a red to a green line and say here is an area, Mr. Banker, where we think that potential for new ideas, forming enterprises, and creating jobs, is at a high level. That is why cutting rates of taxation on future levels of income both for the employer and the employee is critical. Hey, I think it is important to recognize the highest tax in America today is paid by the inner city poor. When you take a job and you are on welfare, you lose welfare and you get taxed on your income and the combination of the lost transfer payment coupled with the tax on your income at the Federal, State and local level, amounts to a tax of about 90 to 100 percent. We are discouraging people who want to work. People are desperate to work. In Buffalo, 2 weeks ago, Henry, you remember, the front page of the Buffalo News had a picture of 10,000 people lined up to qualify for 35 jobs at Anaconda Copper. And they lined up in a rainy climate for 24 hours waiting for a chance to work. People want to work, but we discourage it. We overtax work and we overtax the profit that you make when you work. So the enterprise zone is an attempt to green-line. Just one other thing; I think that if we don't bring interest rates down by restoring the value of our currency and maintaining that value over a long period of time so you could predict the price and the value of money over a long period of time, that is going to inhibit the lending and financial institutions of this country from putting their money out in those high risk areas, and certainly in steel and autos, which the gentleman from Ohio and Henry and I depend upon. If interest rates start to go up, it will shut off housing and autos, Just as they are starting to climb back from their 1979, 1980, 1981, and 1982 lows. As they climb back I think it is going to increase the demand and there will be a worldwide economic recovery.

But if interest rates should turn up, and it shuts off this recovery, then you know the political consequences, much less the economic consequences, would be brutal. So we have two things, a macroeconomic problem of high interest rates and what it does to our trade, steel and autos and manufacturing, et cetera, and then we have the microeconomic problem of what happens if you are a black entrepreneur in the inner city and no one will loan you any money. Not only because interest rates are too high, but because somebody is looking at a red line. But I really believe that if we would say that there is a green line around there, that we are going to encourage that minority enterprise to go in and start a business, and not only that, we are going to drastically reduce his or her tax on the profit and the tax on income from working in that company and reduce the impediments to making a success of that new idea, then I think you can get people to either invest or loan money to that small business, or that new enterprise.

Mr. NOWAK. Thank you very much. Mr. Britt of North Carolina.

Mr. BRITT. The idea I think, is a very attractive idea. It is the kind of creative thinking we need to be doing about these kinds of problems.

My concern, I think, is the emphasis on taxation. Basically, before those things can take effect, you have to have a profit. And I think in deciding to invest funds, the banker has to be first concerned about whether he can make ends meet and not whether he is going to have a lot of taxes. You mentioned Congressman Rangel's proposal, and Congressman Nowak has similar incentives to invest in those enterprise zones, but it seems to me that the biggest single problem for entrepreneurship is capital formation, risk capital availability. Would you address that?

Mr. KEMP. Well, you have made a good point, and it is one that I touched on a little bit earlier in answer to the Chairman's comments about startup capital through SBA. My concern is if you look back over the history of this country, and look over the history of the private enterprise system in this Nation, you find that out of every 10 new businesses that begin, about 8 or 9 ultimately fail. According to David, Birch one of the acknowledged experts in the whole area of economic development, not only do new jobs come from small businesses, but that if the government begins to choose which businesses will succeed by investing in those businesses, it in effect waters down the overall credit and capital availability. By nature it has to decide through a bureaucracy which business has the best chance of making it. The essence Birch says of a dynamic economy is a climate in which a lot of people want to go out and start a business. You cannot guarantee their success but if you remove the impediments to get into business and make a profit, more people will begin to invest and the capital stock of the country will rise.

Now, there were 70,000 bankruptcies in 1982. An all time high. We are told constantly on the floor of the House about them. And it is true. But, gentlemen, there were 700,000 new businesses, small, immature, barely trying to get off the ground that started in 1982 and I think with lower interest rates and less burden of regulation and taxation, in the future, we can have maybe 1 million new businesses a year. Now, imagine 1 million new businesses with an average of five employees. So I would rather have us not try to pick and choose who is going to succeed. You know as I do that there are Members of Congress, Mr. Britt, who want to have a national reconstruction finance corporation to choose the industries of the future and then channel credit and capital and make decisions based upon who they decide to support. I think that would be a mistake. I think that would be antithetical to everything that most of us believe is the dynamics of a healthy market economy.

Now I recognize that seed corn is a problem. However, I would rather have someone who invests in ABC electronics, or ABC auto repair shop in North Carolina or Buffalo be able to sell stock or put out debentures and be able to have an investor write off his or her investment in that debenture at a level of 50 or 75 percent, having the private market choosing or picking or investing or betting on the future instead of having the decisions being made by a bureaucracy in Washington, D.C., which is fragile, frail, and fallible.

Mr. NOWAK. Will the gentleman yield for just a comment? I thank the gentleman. I had just a comment on the Japanese experience. In analyzing, and I can't recall the author's name, but in

analyzing that experience, a team was sent over there and in looking at the so-called control of the Japanese economy, their conclusion was, and it was quite startling from the point of view, that the incentives or the pursuers of the new opportunities did not come from the so-called central government that runs the industrial board that they have formed over there. Rather, what happened, their greatest gains they concluded came from the small businesses and the combination of not only technology but experts from X Company and Y Company pooling together privately without fear of antitrust violation to develop a product in the micro processing area. And they took, I think it was 300 people, 2 or 3 from each small corporation, combining all of that so their technology and research were targeted, and that then floated up to the top. When that development was complete, and that took agreement among whatever structure they have there, to bring that about, they got that agreement. But it didn't come from up high, it was the industry developing that ground swell between labor and management, and then, moving that forward.

Mr. KEMP. One of the biggest myths in this country is the idea that Japan came out of the depths of World War II and the post World War II experience simply by having MITI, the Ministry of Industry and Trade, decide who was going to succeed and who was going to fail. They did not. For instance, Sony was making coffee pots in 1951 and MITI told them to stay in consumer goods. And they decided to go into electronics.

Honda was told by MITI not to go into automobiles, that Japan had no automobile future and Honda was making motorcycles and they decided to go into autos. Mazda was told by MITI to go out of business and to sell off their stock and business and to join with someone else when they made a recovery. My last example is the savings rates in Japan. Fifty-four thousand dollars of income, tax-free per year, if you save it. Their per capita saving rates are 24.5 percent of per capita income. Ours are just barely climbing to 7.

I am not trying to say that Japan is just a free laissez-faire market economy, because it is not, Mr. Chairman, as you pointed out. But they have taken some steps that are in my opinion, giving mistaken impressions to some of our politicians in America as to how to build an industrial base.

Mr. NOWAK. The other point, the Japanese steel industry, is amazing to me in that the amount of the equity debt ratio that has been developed there is exactly almost the opposite in the United States 80 percent of investment comes from equity in our steel industries and 20 percent is debt. Over there you have just the opposite percent; the debt is almost 80 percent and the equity is only 20, and I don't know how that affects their total profit picture.

Mr. BRITT. The only other question, basically, and particularly I think with the tax incentives, do you envision other companies locating in the enterprise zone for those types of incentives?

Mr. KEMP. That is a problem that has to be addressed by the Congress. You don't want to just say to a company, locate in an area such as the enterprise zone to take benefits of higher profits or tax benefits. Former Congresswoman Shirley Chisholm wrote a very interesting article 2 years ago when this debate first started and she made the point that someone might open a warehouse and

use the enterprise zone as simply a paper entity and then operate that business and hire folks from the other parts of the country. We have built into the bill as it is presently constituted, a protection for that because you don't get the incentive or the tax break, or benefit, unless you operate in the zone and you hire people who are so-called disadvantaged by the CETA eligibility standards.

So we tightened that up considerably, thanks to Shirley and others who addressed that problem. Many of the distinguished civil rights leaders in this country, from the Urban League, the NAACP, to the National Urban Coalition, all made that one of their highest priorities. But at the same time, if Bethlehem Steel were to invest in the inner city or Republic or a major company, while you wouldn't want it inhibited, you would want, and make sure, that the jobs went to the people who were in the city.

I think there is protection for it.

Mr. BRITT. Thank you, Mr. Chairman.

Mr. NOWAK. Thank you. Mr. Chris Smith from New Jersey.

Mr. SMITH. Thank you, Mr. Chairman. First of all, let me commend and thank our colleague from New York for his very enthusiastic leadership in the area of putting incentives back into the system and providing economic rewards so people will start their own businesses and hopefully that will be part of the cure to our unemployment problem.

Also I want to thank him for reminding us that incentives work and they cut across all the ideological, race, color and creed barriers that exist. Whether it be in Brazil, Ireland, or elsewhere, it does work, and I want to thank him for doing that.

Finally, I just want to ask my good friend, Mr. Kemp, a question. Do you believe that deferring the capital gains tax perhaps for 18 months as the White House Conference on Small Businesses has suggested, when invested in small business, would be a good idea, perhaps as an addition to this bill or maybe separate legislation?

Mr. KEMP. Deferring it?

Mr. SMITH. Deferring it, yes.

Mr. KEMP. I would abolish it. Deferring it simply says we are not going to tax you as long as you do what we want you to do with it, but as soon as you try to do something other than what we want you to do with it, we are going to tax you, and it is like those who want to roll over capital gains until you sell. It seems to me, that, too, is an impediment to decisionmaking. I would cut the capital gains holding rate to 6 months and—or abolish it for anybody who invests—particularly this bill abolishes the capital gains for anybody who invests an enterprise zone and hires inner city employees. You have got to do something dramatic to change the rate of return on taking the risk of forming a new business in the inner city. We haven't cured education, we haven't cured the crime problem, we haven't cured the environmental problem, but estimating capital gains taxes is just one modest, but yet significant step to doing something different in the inner city. I wouldn't roll it over, I wouldn't extend it or delay it, I would abolish it. Get rid of it. It is a tax on new jobs. The capital gains tax is a tax on the entrepreneur. The tax on the men and women who have ideas and they want to go out and try something and get a piece of that pie. I think, radical though it may be, more and more people are begin-

ning to realize that we need to do something to alter the rates of return on extraordinary types of productive human behavior. It is a modification of behavior in the inner city. That is what you are actually trying to do. You are actually trying to modify the behavior of the inner city, by altering the rewards. Rather than using a stick, you want to use a carrot. I mean—I think that is what this whole thing boils down to. Some people say well, gee, that's not profound enough. It is not complex enough. Well, in effect it is simple but profound.

Mr. SMITH. If the capital gains couldn't be abolished in totality, would you support a—you know, just a targeted—perhaps toward small business, or toward——

Mr. KEMP. Targeted how?

Mr. SMITH. Targeted toward a small business so that a person who does invest in a small business——

Mr. KEMP. Well, you know—I would say to my friend from New Jersey, if I understand him correctly, every bill, left, right, and center, that's on enterprise zones in the inner city abolishes the capital gains tax. You are targeting right there. But simply to roll it over or to defer it, simply says to that potential investor, or potential entrepreneur, that the Government is going to give you an incentive, or a carrot, until you want to do something. And if you and I try to form a business in the inner city of——

Mr. SMITH. Trenton.

Mr. KEMP [continuing]. Trenton, yes, and we want to use it to finance some future goal, it would inhibit that business or your investment if we say we'll simply allow you to keep the profit until you try to use it. Wanting to use that money is as much an incentive to start an enterprise as the actual building of the enterprise itself. Do you see what I mean?

People say we need a consumption tax because we want to punish consumption and reward savings. So we have got to raise excise taxes and cut the tax on savings, but people save so they can consume. It is just ingenuous to say that people are out there working at Bethlehem Steel in Buffalo, N.Y., or Republic, or an auto factory, who don't want to spend that money. So if you tax spending high and you cut taxes on savings and investment, in effect that is as much of a disincentive to the producer as it would be if you taxed away his or her production.

I don't want to sound disingenuous, but I really believe we should abolish it.

Mr. SMITH. Thank you.

Mr. KEMP. Thank you.

Mr. NOWAK. For the record, I would like to get your comments—some of the problems that I have seen regarding this piece of legislation, in comments from others and other committees is the problem with the deficit.

And I would really like to get your comments on the record concerning this, as we will be facing this argument, from the first day we start this to the last day it is finished. The deficit, as everybody realizes, has gone up to $129 billion with the circle causing inflation and then the inflation causing the interest rates to go back up. We both have I think for a long time fought this high-interest rate

phenomenon, to the point where we even tried to do something with the structure of the Fed.

Mr. KEMP. First of all, the cost of the bill would be minimal, Mr. Chairman. How can you lose revenue by cutting tax rates in the Ellicott District of Buffalo, where there are no businesses. All you are doing is telling them if they can make a business go, that they will have a lower tax. So in effect you are building a tax base by trying to get someone to invest in Ellicott or Lackawana or areas that you and I are familiar with, and other parts of that district.

Second, it has been estimated by Treasury that the cost of the whole bill, 25 enterprise zones per year for 3 years, would be something like $900 million. It seems to me that is one heck of a small cost to pay by increasing the deficit of $1 billion when you have got $129 billion of deficit. I would rather take the risk than not do it at all.

Third, this deficit is related to unemployment. Get the unemployment down, get steel, autos, and housing back on their feet, get agriculture competitive in the world again, and the deficit will come down as unemployment comes down from 10½ million to 8½ million, or 5½ million, or 5 or 4 percent. Our deficit as a percent of our gross product is 5 percent. Japan has been running a deficit as a percent of their gross national product of 6 percent, 7 percent, for 5 years, 6 years, 7 years. The question is what are you doing to get the economy growing and—I guess my radical position, Mr. Chairman, is that the deficit is not driving the interest rates. The problem has been caused by the breakdown in monetary policy and the high interest rate policy that the Fed has followed for 4 years that has caused a contraction in steel, autos, and housing. As unemployment climbed from 6 percent to almost 11 percent with each 1 percent of unemployment drove the deficit up by $40 billion. You put those people back to work; they'll pay taxes, transfer payments will drop, revenues will rise, and as we come out of this recession, profits will begin to pick up, incomes will begin to pick up, and revenues will grow and that isn't Jack Kemp, or the Laffer curve or anybody else. It is a fact of life. Spending as a percentage of GNP was 21 percent in 1981. We all thought we cut spending but today in 1983 we are talking about 25 percent of GNP in spending. Why? Because of the economy. As the economy contracts, unemployment goes up, spending goes up. The reverse is also true. Get the economy healthy, get people back on their feet, get people working, the factories at higher levels of utilization, and spending as a percentage of GNP will drop from 25 to 23 or 22. Revenues as a percent of GNP went down in the recession, from 21 to 19, but in an economy that is healthy, they will go back up to 21. So you have a 1 percent of GNP or 2 percent of GNP as a structural deficit, I would be happy to live with 2 percent of our GNP deficit. In an economy of $4 trillion, someday soon, 1985, 1986, I think we can live with a $50 billion deficit.

Mr. NOWAK. Well, the point I would like to address is the interest rates, which I agree are absolutely critical. We cut $750 billion in revenues. Without response from the business sector and without response from the financial communities, we have the biggest deficits in the history of the country. The national debt will double from 1980 through 1988, unless we do something about it. We are

looking at a $200-billion deficit this year. If the Government goes to the market and borrows 70 to 80 percent of the private capital available, how do you expect interest rates to go down?

Mr. KEMP. Well, let me go back to my thesis. Interest rates went up in 1979, and there was no deficit of 5 percent of GNP in 1979. You weren't here but some of us were, and in 1979, 1980, when President Carter was President, if you remember, we came awfully close to balancing the budget in the first congressional budget resolution of June 1980. It was balanced—$612-billion revenue, $612 billion of expenditures, on paper, I admit, and the interest rates at that time were 17 percent. The Federal funds rate, Mr. Britt, was 16. And who sets the Federal funds rate? The Federal Reserve Board. They set it there, auto production went down from 13.5 million in 1978, to 6 million by 1981. There were 2.2 million housing starts in 1978; they went to 600,000 by 1981. You shut off housing and autos, you shut off secondary and tertiary industry, you shut off steel and manufacturing, you shut off our exports, and as unemployment climbed, the deficit climbed, and I submit to you, sir, excuse my passion on this subject, but everybody thinks it was the tax cut. The $750 billion—that suggests that you could have raised $750 billion over the next 4 years and not had any bad consequences in the economy. That suggests, sir, you could have raised the income tax on the American people by 45 percent over the next 5 years and not have anybody change their decisions as to what they are going to do with their productive human behavior. That suggests that if we hadn't done something to restore incentives, in this area, that the economy would just have floated back on its own. I don't buy it.

Mr. NOWAK. The concept was that there would be encouragement for investment of capital and actually that has not been the trend.

Mr. KEMP. Interest rates were kept at 16 percent. The Federal funds rate was kept up by the Fed. At 16 percent that kept up the consumer loan rates at 19 and 20 percent for 4 years. You can't buy a house. I don't care if you are a Keynesian or a supply-sider or Milton Friedman addict, no economic theory can work if the Federal Reserve Board absolutely shuts off the oxygen that is so critical to those industries and our agricultural system and our exports and, again I am not asking you to believe it, I only say it to get you to maybe look beyond just the conventional wisdom that you read in the editorial pages of the morning paper. And I think it is important that we look in that direction. I am not saying I am right, but if it is true, I think it is something that we should pursue.

Mr. NOWAK. We're going to excuse you, after one more question, Jack. This will be the last question.

Mr. WILLIAMS. This perfect question in the discussion is: Where is the administration? Are they with us?

And I am on your side.

Mr. KEMP. I'll tell you what, when you become President and I'm your Vice President in 1988, we're going to go to Pittsburgh, Youngstown, Buffalo, and Detroit, and we are not going to talk about computer jobs, we are going to talk about steel jobs and auto jobs.

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Mr. WILLIAMS. I don't want to put you on the spot, but in your best judgment, are we going to get something moving here?

Mr. KEMP. Well, something is moving; the question is whether we're going to retard it or the White House is going to retard it. Paul Volcker has changed his monetary policy. He has moved away from simply targeting the money aggregates, and he is targeting interest rates; he's looking at the economy; he's looking at Lombard Wall and Drysdale Securities, in Mexico, Brazil and Argentina, and the Third World; he's looking at the economy; he's looking at the exchange rates; he's far more pragmatic today and I think we should encourage that. That is one reason why I say, "Hey, look at monetary policy." And I appreciated Henry Nowak saying, "Hey, look at monetary policy." Jim Wright and Bobby Byrd told the Fed in a bill that passed—and I supported it, not because I thought it was perfect, but because I thought it was important to tell the Fed—stop simply targeting how many angels can dance on the head of a pin, and start looking at interest rates. Start looking at the prices, the stability of prices which can help bring down interest rates—and housing is beginning to climb. It is 1.4 million on an annualized basis and it is certainy climbing. A 30-percent recovery in housing in just 1 year; autos last month, 5.7 percent. Minimal, but it is up. We need more sales and that requires lower long-term interest rates. The stock market is at 1,200. That's a sign that somebody is investing in the future of this economy. They don't just move by animal spirits. Something is happening out there. The question is if we start taking off the third year, if we start taking off indexing, if we start trying to raise taxes to get that deficit down, if we try to spend our way out of this mess, or if the Fed decides to turn up interest rates, that would be, I think, it would be disastrous.

So I hope—I don't want to say stay the course, because I don't like the term stay the course. I want to change the course in the sense that I don't like the status quo. But I don't want to change the ingredients that are there, that can bring us out with a recovery, but we need to do more. That is why enterprise zones are so important.

Mr. Chairman, thank you, personally and——

Mr. NOWAK. Let me just conclude your testimony by saying we did invite some HUD officials to testify and at this point in time they declined. And I hope that we can both encourage them to become more active in this area——

Mr. KEMP. The administration, Mr. Chairman, has not done enough to sell the bill—to send the bill up here, and I want to thank you and others on both sides of the aisle, who are apt to get this thing started. The administration should do more.

Mr. NOWAK. I think there has been some lip service, but I agree with you that we have to get more focus on this bill both from the administration and other members here.

Mr. KEMP. One last point, Mr. Chairman. If you and I and this committee could get the Ways and Means Committee to move, if Mr. Rostenkowski, the distinguished chairman of the Ways and Means Committee, would hold hearings, that would be very, very helpful.

Mr. NOWAK. We are going to provide them with this record. We appreciate the time you have spent with us and hopefully we will look forward to positively moving this in the very near future. Thank you very much for your time and attendance.

Our next witness is Mr. John Foley. Mr. Foley, if you will take the chair. Mr. Foley is director of community development of the city of Warren, Ohio. He has worked in community development for the past 14 years and has served as director for this agency for approximately 6 years. Mr. Foley has had a long and distinguished career in public service and is certainly well respected in the Warren-Youngstown area for his community development expertise, and it is a pleasure to have you before the panel.

TESTIMONY OF JACK FOLEY, DIRECTOR OF COMMUNITY DEVELOPMENT, CITY OF WARREN, OHIO

Mr. FOLEY. Thank you, sir. I think before I start, Mr. Chairman, I would like to give a brief description of Warren, Ohio. It is a city of nearly 60,000 people in a county of 250,000 people located right in the heart of the most severe economically distressed area of the country.

With that, Mr. Chairman, I am pleased to speak with you today on the problem of displaced workers and business opportunities in distressed areas.

I realize this hearing today is not specifically on H.R. 2375. I would like to start out by complimenting you, Mr. Chairman, and Congressman Williams, for introducing this much needed bill.

Some facts and figures which I know Congressman Williams is very familiar with and I am sure you are also: The unemployment rate in the Mahoning Valley is in excess of 20 percent, twice the national average. This is a true economic disaster, no less a problem than a natural disaster. For the Congress to fail to address this situation, particularly in the Mahoning Valley and those other areas with major unemployment problems, would be an abdication of its responsibilities. The bill which you have introduced goes a long way to addressing the situation, and with your indulgence, I would like to review portions of the bill in hopes that it would lend some assistance as you give this legislation further consideration.

Before I do this, however, I would like to take the opportunity to invite the subcommittee to the Mahoning Valley for a firsthand look at the problem and I do so in the hope that such a visit will give the subcommittee more information that will be useful in securing passage of H.R. 2375.

With that I would like to venture into some of the concerns I have as a practitioner. I accept the bill and it is a much needed bill. So in my mind, it is a foregone conclusion that it will be passed and be used as an economic development tool.

With this, we hear much talk about zones and size and other countries. I think you must be particularly cognizant of the fact that when they state some countries utilize the enterprise zone, some of our States are as big as some of the countries they are talking about. This gives me a problem as a practitioner saying, how do you, for example, set up a zone in Youngstown, Ohio, and say Youngstown needs this and we are going to designate them a

distressed area and designate a city 17 miles away with equally as many problems a nondistressed area, noncompetitive, denying it the opportunity to ask for the same advantages that this bill is presenting. I wonder, in fact, why would an industry want to locate in a Warren, Ohio, with no incentive programs, with a Youngstown, Ohio, having the incentive programs? Make it a Cleveland, make it any county, make it in any of the other States. This is a concern, and I think you must address this very carefully as this legislation is brought forward. The venture capital that everyone says will become available will bring investors who are willing to go with this program. Certainly they are willing to go with it, but not in distressed areas. If you were going to invest dollars, you wouldn't take the most distressed area in the country and say, gee, I think I will have a great success at making money here. You are going to take your venture capital where growth is taking place. And it is not in our area.

So I think we do need help. I think the word targeting has been used; it has continued to be used, and I think it ought to mean something. I guess the biggest concern I have with the bill is the fact that any legislation that says 1 percent above the national average is entitled to help, is not targeting. If you have a flood, everyone is very willing to go down, help this area that has the flood, give it immediate relief. No one seems to come in and say, well, if you have a heavy rainfall, we'll help them also. I think that there should be a true distress test; it should be much more than a 1 percent above the average. This would go a long way in reducing the potential cost of this bill.

Those are my concerns and I would like at this time to ask a couple of questions. Being I am on the firing line trying to make these bills work, and make these development tools work, they do present a problem. For example, in here you talk about a population of 50,000 being entitled to certain things, then later on on page 17 you say that if you are 100,000 you can go ahead and design your own plan. HUD says 50,000 becomes an entitlement city or a small city. I think someone has to review these bills and start making the numbers consistent so that we don't create complete confusion out in the world of economic development tools in trying to help persons.

Mr. NOWAK. Thank you very much, Mr. Foley. You know, one of the problems, HUD is not here today. When they devised their 25 startup zones, I believe the input into that number was made because of some lack of enthusiasm, especially on the side of lost revenue, as they termed it. On top of that, of course, they have structured a program which I consider to be competitive and counterproductive. If we are going to try to help the worst sections of the country, the local incentives that are supposed to be part of the criteria for eligibility would cause a local community that is already hard pressed to have a difficult time in meeting those local incentives to complement the bill. Thus, they would be in direct competition for a zone, and that might defeat the whole purpose.

Your point, I think is well taken about whether, and how many areas are eligible. In giving some thought to this, if you had the ability to structure the bill, have you given any thought as to how you would try to designate the areas in terms of rates of distress or

how the eligibility factor could be put in place, and second, would you make a competitive situation in the local incentives as a criterion to make the strongest case for a zone?

Mr. FOLEY. Let me answer the second part of that first. As far as the competitiveness goes, I have no problem with that. We ask business to be competitive every day. And myself as a practitioner, I do not mind going head to head. All I want is a fair opportunity to compete with the same tools.

Mr. NOWAK. That's the point. Would you in Warren have the same opportunity as—let's take a growing area—Houston?

Mr. FOLEY. No, we do not have the same opportunity and that is the point that I bring up when I say that 1 per centum over the national average really lets almost anyone participate in the program. And if we are really out to help and assist, and we are calling this a distressed bill or a targeting bill, then I think we ought to do that with it.

And I have no problem standing up to the country and saying we are not getting a part of it; the bill is not designed for you to get a part of it.

Mr. NOWAK. What percentage would you take?

Mr. FOLEY. I would like to see it go 3 to 4 percent at least, over the national average. I don't think 1 percent over the national average really dictates to a large problem for that area.

Mr. NOWAK. Let me ask you this: On a local level, has your agency found any workable solution to the problem of displaced workers in your community?

Mr. FOLEY. No, we feel that most people do not want to get up and leave the areas they now reside in. I think we are going to have to take retraining, but as Mr. Kemp said, I also do not think our answer is in high technology. I believe it is right back to where we are now, our industrial base. And the two- and the three-job type of business is going to bring us back. Not everyone can make a chip and if we retrain, retool, and permit these people to have some working capital and some venture capital, I think we can get things started again.

Mr. NOWAK. In what form would you believe that the venture capital would work best. In our bill, as you know, we have tried to make use of the EDA programs, the SBA also, and try to bring into force a new feature of deduction for investment up to $40,000 for a married couple.

Also in the bill is the increased leveraging of SBIC's. Do you think that would be an adequate mix, or do you personally favor that incentive, and also do you have anything to add?

Mr. FOLEY. I think the bill, the tools that are offered, are very workable. I think the incentives provided are very workable, but we still have to address the other concerns, that we don't spread it so thinly that we really help no one. Most of the small businesses I deal with on a daily basis cannot come in as a startup business and now say I have my life savings to invest. They have no life savings to invest. You must be able to go out and offer them up front dollars to put them in motion. Once they are in motion, the tax incentives are great. How do you get them in motion?

Mr. NOWAK. So you do feel there is a need for some type of capital infusion.

Mr. FOLEY. Yes.

Mr. NOWAK. Whether it is through the tax code or an overt program, or——

Mr. FOLEY. Yes, I think you have to put dollars into the business to get it going. Right now most enterprise zone bills that I have read address the very large corporation that can get a great advantage on the tax incentives. He already has the money to start up. I think if we are really going to talk small businesses, we have to help them get started.

Mr. NOWAK. Thank you, Mr. Foley. Mr. Williams.

Mr. WILLIAMS. Jack, I appreciate your testimony and your telling the story firsthand how the things we do here filters down to the local level and the inability it provides to you because of some of the confusion as well as the help it provides for you to deal with the problem on a daily basis.

I guess I simply want to say that I think you would have to agree that one of the major problems that face us as we talk to new businesses wanting to locate in the Mahoning Valley, Warren-Youngstown, is the reluctance of the banks, and this may be an attitude that exists. As you know, the banking community in our area is a very strong banking community, even though it has been a very hard-hit area. What would you suggest, if you do have a suggestion, that we could use? What would be your suggestion to deal with that reluctance? I think a lot of it is attitude, and that is difficult to deal with. But I, like you, know that there are many small businesses interested, and in fact, attracted to a very hard-hit area knowing that there is government relief out there and government help out there, and then find that when they go and get through all of that and get all the assurances from your agency, they fail because of an attitude maybe in the financial community.

Mr. FOLEY. I think what is happening in the banking industry that has hurt the small communities, and it just happened in our town, the major bank was bought out by a conglomerate. We no longer have the personal touch with the community. The banks go out and they want to invest wherever they see the biggest dollar return and it certainly isn't in a distressed area. They no longer say, hey, the people in this bank have made this bank what it is, and we have their local dollars. Since they are all bought out and they have major holding companies now, you have lost that contact. And there is the reluctance to invest in distressed areas. They don't have to, because they pool the money, take the money out of the local bank and apply it where there is a very healthy economy. You as an investor would do the same thing. So we have to create tools and incentives to keep the people and offer a special package to want to keep them in the distressed areas.

Mr. WILLIAMS. I agree with you that people that tend to be attracted to our areas or maybe steelworkers who have worked in the mill for 30 years and have small savings, but do not have adequate savings to start up a big business or to perfect an idea to put a small business in place.

Maybe I will conclude by just saying that again I appreciate your indulgence and support as we try to struggle with this problem and maybe ask you one final question.

If you could make a list of helpful tools to deal with the attracting of new business ventures, small or large, maybe give me two or three of the programs that would head that list.

Mr. FOLEY. At the risk of putting names on the board, I like the UDAG program and will sit here and support it as long as I am here. I think it is a very valuable tool. I like this program very much. I think it is needed, but I don't think we can wait with it. I guess we must get out and be willing to take a chance on our small businesses and quit wanting them to leave their left arm with the bank or with the city or with the county, for them to go ahead and start up in the area. It seems to be we want them to certify success and I don't think anybody can do that. They can only have some degree of reasonable possibility and I think that is what we have to deal with. I would like to add one more thing, in the enterprise zone question that has come up through the again practitioners, UDAG comes out and they say to you as a city or local development—we'll use city, since I am from a city—you go out and you get a business and we will give you this money and this is to help you increase your tax base. We need increased local tax base because everyone wants the amenities that it provides. They say we need good schooling, we need a great social life, we need the amenities.

But on the other hand we come with an enterprise zone which we are going to try to mix this UDAG program with and they want the local people to abate the taxes. Now which one are we supposed to do?

Mr. NOWAK. When the administration proposed their local incentives in their bill, to build a competitive program, many of the mayors look at that as a real problem of additional servicing. They look on putting in an industrial park in addition to costs of police and fire departments and the collection of refuse, and so forth, as an additional burden. And if they would have to pick up that cost themselves, and then spread that cost to the rest of their tax base where it is declining already, this could cause real problems. What we have tried to do in our bill is put some through EDA and other means to provide some way for that infrastructure to be put in place, and then the servicing and other costs of that so-called zone would not fall directly upon the community. It would truly be an incentive without additional burdens upon the community. I think what we are trying to do in the bill, is to get a comprehensive approach to the problem.

Mr. FOLEY. But when you try to infuse and mix and match these, there is tremendous conflict out there and I say please, please look at that and try to mesh the programs so that they are workable.

Mr. NOWAK. Mr. Olin.

Mr. OLIN. Mr. Foley, I think you pretty well have answered most of the questions I have for you. You might embellish one area a little bit for me.

I take it that your feeling is to try to stimulate small business, new business in a really depressed zone through tax incentives alone. The major emphasis you feel is probably going to be pretty tough, I take it.

Mr. FOLEY. Yes, that encourages only the major businesses, with their expansion, that do not need help to get started. We are trying

to get the economy back on its feet, that says let's put new businesses in place. You can't put them in place with just the tax incentive program. You must offer capital help.

Mr. OLIN. With a priority on availability of capital.

Mr. FOLEY. I think you have to couple the two because I think that the tax incentive is very good but I want the big business to come with the small business. I don't want to say just the small business. If all they need is a tax incentive, fine, but I think we need a tool to offer assistance, should they need more than that, being venture capital, or call it whatever capital you like.

Mr. OLIN. How about the area of operating costs, and the small business' ability to survive in the early stages. Do you see a need for help in that area?

Mr. FOLEY. Yes, I think that that is where most of the programs help. I think this is again going back where you can generally get governmental programs to either defer interest, defer payments, give them a startup time. A banker, even though the bank may be willing to loan you money, is going to want his money coming back next month, which puts a burden on you and again, the operating cost is right now. He hasn't even made a product and he is starting to pay bills. I think there has to be a mechanism to delay this. Even if you want to put it as a loan, and I am not saying that the loan is bad. I am just saying we have to put it in place, so that they can make it affordable and start paying it when the business becomes operative.

Mr. OLIN. To what extent do you think the city has the ability to help with operating costs?

Mr. FOLEY. Very little in our area. I think that in the true distressed area that is very much the case. Most are laying off police and fire personnel. I don't know how they could ever go out to their constituency and say we are going to lay off two more policemen, so we can put these other three people to work, and we have just lost six policemen. That doesn't make good mathematical sense.

Mr. OLIN. OK; thank you very much.

Mr. NOWAK. Mr. Chris Smith, from New Jersey.

Mr. SMITH. Thank you, Mr. Chairman, and Mr. Foley, I want to thank you for the very candid remarks. I think this committee is much the better for your hands-on experience and sharing that with the committee.

I have one question. Most of them were answered during the course of the questions, but one remaining question: How do you feel that the 25-percent investment tax credit would fare in Warren? I understand there is a preponderance of old buildings in that city.

Mr. FOLEY. I think that it is a very much integral part of this bill. I think you ought to try to leave that intact. I can speak firsthand. We just had a development take place in our downtown. Because of the historical designation which also carries that 25-percent credit, that made the deal work. They were really almost as concerned with the tax credit as they were with the inclusion of a UDAG loan.

Mr. SMITH. I just point out that I have a city in my district, the city of Trenton, that has a very large number of older buildings. As

a matter of fact, much older than 20 years and we would also benefit greatly from it.

Mr. FOLEY. You have to the world know, what that really means. Most do not understand investment tax credit. It is very difficult to explain. You need to have someone in your area become very knowledgeable and go out on a firsthand basis and tell this business what that really means. Most are awed by taxes and they don't want to hear it.

Mr. SMITH. Thank you, Mr. Foley.

Mr. NOWAK. Thank you very much. We appreciate your time, and as we start to develop this bill, Mr. Foley, hopefully we will be able to get back to you and develop some more specifics, because I think it is very essential that we do come up with something that is practical. I think unless it is broad enough to do the job, we may be passing something that is not going to answer the problem that is out there. We are going to be once again developing a program that is supposed to work and nothing will develop and the situation will deteriorate after that and everybody will forget about it because we passed some "legislation."

But I want to thank you for your time and wish you well in your problem and your struggle.

Mr. FOLEY. Thank you for the opportunity.

Mr. NOWAK. Our next guest will be Dr. William T. Ganley. If Dr. Ganley will come forward. He is a director of the Center for Applied Research in Urban and Regional Development of the State University College of Buffalo.

Dr. Ganley holds a Ph. D. in economics from the University of California at Berkeley. He was formerly chairman of the Department of Economics at Buffalo State College and has been working in regional economic development, labor market analysis, and business development analysis for the past 7 years.

Dr. Ganley, it is a pleasure to see you once again.

TESTIMONY OF WILLIAM T. GANLEY, DIRECTOR, CENTER FOR APPLIED RESEARCH IN URBAN AND REGIONAL DEVELOPMENT, STATE UNIVERSITY COLLEGE OF NEW YORK AT BUFFALO

Mr. GANLEY. Good to see you.

Thank you very much for inviting me to comment on the enterprise development, industrial revitalization proposal.

Let me tell you a little bit about my background, my understanding of business development and business activities, particularly with regard to small business.

In 1977, I designed and conducted a study of Buffalo based business firms that included contact and direct interviews with over 990 businesses in the Buffalo area. We attempted at that time to determine what sort of growth patterns existed and would exist in Buffalo over a 3-year period, what types of problems those businesses faced in terms of the adequacy of loan funds, capital, of the transportation system in Buffalo, and what opportunities there might be to more effectively target Federal employment funds, et cetera.

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In 1980, we did a study of the businesses along the main street quarter in Buffalo, adjacent to the Light Rail Rapid Transit Line which is being constructed in Buffalo. At that time we were able to identify 225 businesses along that quarter, had direct contact with 140 of them, and did an in-depth interview with 30 of those business firms in terms of their credit and financial needs during the period of construction.

Finally, the most pertinent to today's discussion—Fred Witthans, a colleague of mine at Buffalo State College and I have attempted to develop a model which evaluates economic development incentives. Employment and investment tax credits, as well as subsidized interest rates through both Federal and State financial programs.

In looking at the whole series of economic development tools that exist either through the Federal Government or through State governments, we of course were primarily interested with New York State's programs and how effective they were. We attempted to compare what sort of success a program would have in terms of employing people with regard to new jobs generated and the effectiveness of subsidized interest rates as compared to employment tax credits and direct investment tax credits.

It becomes very clear if you look at a series of economic tools that are available that, in order to generate new jobs, the emphasis has to be on employment tax credits directly; to the extent that you have across-the-board investment tax credits which may be successful in stimulating funding for businesses, you will not necessarily generate jobs to match up with those tax credits. What is appealing about the enterprise development industrial revitalization bill is that it takes that into account, and emphasizes the importance of the employment tax credit.

Coupled with that emphasis, it identifies the serious problems faced by areas such as Buffalo with a large number of displaced workers, the proposed bill attempts to set in motion a vehicle which will move those tax credits toward business firms which will in fact employ displaced workers. In the Buffalo, N.Y., region labor market at the present time there are over 30,000 individuals who are counted as displaced workers. That is in a regional labor market of less than a half million people. And it is an unemployment rate which has ranged in the last 6 months anywhere from 15 to 20 percent.

One of the other features of the bill which is particularly attractive is that it calls for local authorities both in government and private sector in an economic development agency to develop an investment strategy. An investment strategy would take into account the available resources in the community, and the various purposes to which the tax credits and loan fund might be used.

In talking about the startup of new businesses, and the need for working capital for new businesses, I think it is true that most new businesses start out of personal savings, perhaps putting together creditors and investors on a very small scale, usually among friends, relatives, et cetera, and once they are off the ground, and working, they run into problems with regard to the accessibility credit from regular credit markets. I think the idea of a regional revolving loan fund that would provide matching working capital

loans, tied specifically to new jobs being created, could work very successfully in an area like Buffalo. I think it is probably essential that for assisting new businesses, not only is the credit to be some type of seed funding, whether that comes through a new regional economic authority, or whether the existing economic development agencies are the vehicle used, or whether a not-for-profit private sector entity carries out that role. I don't think it is the major point. The need for seed funding of one form or another is essential for new businesses to get started.

The third point I will make, and then I want to point out several of the difficulties that I see with regard to trying to carry out an investment strategy in the planning process for any area of the country. The notion of using displaced workers category and tying employment tax credits to that is a very desirable one. I think at the same time one would have to look very closely at job training funds in general and try to provide a mechanism or review to make sure the job training funds coming into an area are matched with any type of enterprise development. The two cannot go off in different directions and I think that one of the strengths of this bill would be the opportunity to look for an investment strategy for an area and identify the resources necessary.

Now, with all that said, I think that the creative nature of the financial proposals in this probably are in the spirit of where capital credit markets in this country originate from. Regional base finance has been the basis of regional development and new business starts since the origins of this country. It continues to be today despite the fact that our attention is too often drawn to the major capital markets and major credit markets. The notion of having a regional emphasis in this bill that creates new opportunities for local investors who have an interest in the community, an interest in maintaining and rebuilding a community, is probably essential. It seems to me in reviewing the various modifications of the Small Business Investment Act, what is being suggested is very desirable. It may be critical to actually get things stimulated for new investors in Buffalo for reinvest in those new businesses absolutely necessary to deal with the long-term employment situation in Buffalo.

Two points of caution I have about the ability to see something like this program work: (1) At the present time labor market information on a regional basis is inadequate to really assist anybody trying to lay out an investment strategy or plan for a cost effective utilization of the various programs that are identified. It would really require that some amount of funding be utilized to more effectively gather and analyze the labor market information that is available; and (2) the caution that I have with regard to the availability of information and data. At the present time, economists who are attempting to analyze new job formation, new job generation process, really are just beginning to scratch the surface. The MIT job generation studies and the more current Brookings job generation studies, I think, point in the obvious direction, that most new jobs in this country are in fact created by very, very small businesses.

If you accept the notion that I am, what might be called a reformed econometrician, a model builder who likes to crunch numbers. The first thing that struck me about the job generation data

is that it hasn't been around very long, we haven't had really very much experience with whether this is particularly relevant for a very limited period of time, whether the next 20 years are going to be reflected in the types of job generating numbers that have come out of the major studies. I happen to agree with the methodology both of MIT and Brookings; I just caution anyone using the numbers, that is not gospel that two-thirds of the jobs that have been generated in the last 7 years were created by firms that employe 100 less employees. There have been several major studies that indicate that. There is no reason to believe that that same pattern will continue to exist. So that in endorsing the methodology which has been used, I suggest that we need to know a lot more about the pattern and the nature of small businesses in particular communities. What we have at the current time is a series of studies that attempt to take microbased data which is national in scope, aggregate that up into a position to talk about specific time periods. I would suggest for a successful investment strategy associated with the enterprise development in the industrial revitalization bill that more attention be given to new survey information to identify what type of employment patterns actually exist, updating of past studies that have been adequately created in the past is one approach. I think that for an area like Buffalo where we have a very successful record in both terms of utilization of economic development tools and cost-effective studies that those types of studies are best served at the local level, using local consultants, academic researchers, people in local government.

With that, I think I have highlighted the significant points of the bill are, and some concerns I have about actually being able to see this carried out successfully.

[Mr. Ganley's prepared statement follows:]

Prepared Statement of William T. Ganley, Director, Center for Applied Research in Urban and Regional Development, State University College of New York at Buffalo

In attempting to encourage the formation and expansionof business, both the Federal Government and N.Y. State Government offer various subsidies to firms. Such subsidies take the form of either tax credits or reduction in borrowing costs. This paper examines and compares the major programs.

FEDERAL PROGRAMS

Investment Tax Credit

Present Law - Under existing law, firms are granted an investment tax credit (ITC) for investments in tangible personal property (generally excluding buildings or structural components). The benefit derived from an ITC depends on the life of an asset as classified under the Accelerated Cost Recovery System (ACRS). A six percent credit is given for assets in the three-year class and a 10 percent credit for assets in all other classes (see Table 1). The tax credit is used to reduce the firm's Federal corporate tax bill.

However, it should be noted that an ITC of 6 or 10 percent does not result in taxes being reduced by the full 6 or 10 percent. The actual reduction in taxes is much less. An example will be given in order to illustrate the problem.

Assume a firm undertakes a $1 million investment which qualifies for a 10% ITC ($100,000). Under a revision of the 1982 Federal Tax Code, one-half of the ITC ($50,000) must be deducted from the cost of the asset for depreciation purposes. That means the depreciable basis of the asset is $950,000 instead of $1 million. Profits for tax purposes are, therefore, stated higher than they would have been without the tax credit and consequently also the firm's tax liability on those profits. The net result is that over the life of the asset the actual saving in taxes is given by the following.

$$\text{Tax Savings from ITC} = \text{ITC}\ (1 - t/2) \quad \text{in dollars}$$

where t represents the firm's effective tax rate. In the previous example, if the effective tax rate is 40 percent, the actual tax savings is $80,000 and not the full $100,000.

Classes for tangible personal property and certain real property

Class	Type of property
3-year	Autos, light-duty trucks, tractor units for use over the road; research and development equipment; race horses more than 2 years old; horses (other than race horses) more than 12 years old; certain otehr short-lived assets such as special tools with a depreciable life of 4 years or less under prior law
5-year	Machinery; equipment; public utility property with a depreciable life of 18 years or less under prior law; all other tangible personal property not in the 3-year, 10-year, or 15-year classes
10-year	Public utility property with a depreciable life greater than 18 years but not more than 25 years under prior law; theme and amusement park property; railroad tank cars; manufactured homes; qualified coal utilization property
15-year	Public utility property with a depreciable life of more than 25 years under prior law

Enterprise Zone - Under the Reagan Administration's Enterprise Zone (EZ) proposal an additional ITC will be granted for business located within zones: an additional five percent credit for assets in all other classes, and an additional 10 percent credit for 15 year real property (applies to either newly constructed or acquired property).

Employment Tax Credit (ETC)

Targeted Jobs Tax Credit (TJTC) - Under existing law firms are given a tax credit for hiring disadvantaged workers. The credit for the first year of employment is 50 percent of the first $7,000 of wages and for the second year is 25 percent of the first $7,000. For determining tax liability on profits, the firm must deduct the tax credit from wages. That results in profits being stated higher than they would have been without the tax credit, and consequently the tax liability is higher. The tax credit is then deducted from the tax liability.

The net result is that the actual savings in taxes is given by the following:

Tax Saving from TJTC = TJTC (1 - t) in dollars

where t is the firm's effective tax rate

Enterprise Zone - Under the EZ proposal, two separate employment tax credits are granted: (1) a general tax credit of 10 percent on the first $17,000 of wages paid to each employee; and (2) an additional tax credit on wages paid to qualified disadvantaged workers with no maximum limit (starting at 50 percent of wages for the first three years and declining to zero by the eighth year of employment). Again the tax

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[illegible] must be deducted from [illegible] services.

Employment tax credits under the EZ proposal are [illegible] than under the ITC program. Not only does the EZ program apply to all workers but in addition the tax credit for disadvantaged workers is greater with no maximum limit and lasts for a longer period of time.

Subsidized Borrowing Costs

Industrial Revenue Bond (IRB) - Under this program, firms receive a subsidy in the form of reduced borrowing costs. The program provides for up to 100 percent financing for a project. The interest charged on an IRB is approximately 75 percent of the prime rate. The annual savings to the firm can be designated as:

annual interest savings = $i^* \cdot I$

where i^* represents the difference between the market rate of interest and the rate on IRB financing and I represents the value of the investment. Additional benefits include exemption from the N.Y. State mortgage tax and from the N.Y. State sales tax on construction materials. These additional benefits could be viewed as increasing the value of i^* and would increase it by approximately one percent.

There is no indication from the Reagan Administration that this program will be cut off it the EZ legislation is passed. Nevertheless, for purposes of comparison only, the benefits of this program will be compared with the EZ benefits.

First, in order to give some perspect ve to the comparison, the general 10 percent ETC of the EZ proposal will be compared with the annual interest savings. The ETC can be designated as:

employment tax credit = $0.110 \cdot W$

where W equals total wages for an industry where workers earn less than $17,500 a year. For the benefits of the two programs to be just equal, the following equality must hold:

(2) $i^* \cdot I = 0.10 \cdot W$

Given current market conditions the value of i^* is approximately 5%, probably an overestimate. In order to apply equation (2) to available empirical data, both sides of equation (2) will be divided by sales (S).

(3) $0.05 \cdot I/S = 0.10\ W/S$ or

(4) $I/S = 2 \cdot (W/S)$.

If wages, for example, equal 25 percent of sales, then investment must be 50 percent of sales for the two programs to give equal benefit. If investment is less that 50 percent of sales, then the EZ program, based on the 10 percent general employment tax credit alone, would give a greater benefit. In what follows, the tax credit for hiring disadvantaged workers is included in the EZ program but the additional ITC is left out.

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[illegible] firms workforce would be made up of disadvantaged workers. In a separate paper, it has been demonstrated that employment of 10 percent disadvantaged workers would increase the tax credit by 3.57 percent. Thus the total employment tax credit on wages would be 13.57 percent for the EZ proposal. Data on wages as a percent of sales was obtained from the Census of Manufacturing.

The investment-sales ratio was obtained from data supplied by Robert Morris Association Annual Statement Studies. In that publication, three different values (upper quartile, median, and lower quartile) were given for the investment-sales ratio for each industry. Two comparisons of the IRB program with the EZ program were made, one using the upper quartile figure (most favorable for IRB) and one using the median figure. It was found that of the 146 industries examined, the IRB program gave a greater benefit in only 20 industries using the upper quartile figures, and in only 5 industries using the median figures.

Urban Development Action Grant (UDAG) - The UDAG program is similar to the IRB program in terms of reducing borrowing costs. The major difference is that borrowing costs could be reduced to zero under this program and in that case, i* for UDAG would equal the market rate of interest.' Again a comparison was made, this time between UDAG and EZ. The value of i* was assumed to be 13 percent for purposes of comparison and the employment tax credit was again assumed to be 13.57 percent of wages. Using the upper quartile figures for the investment-sales ratio, 91 of the 146 industries would receive a greater benefit from the IRB; when the median figure is used, 41 industries would receive a greater benefit.

STATE PROGRAMS

Investment Tax Credit

The State of New York offers an ITC - to offset the corporate franchise tax. The credit is 6 percent of the cost of the project for the first year and 3 percent for each of the next three years. The total ITC is thus 15 percent of the cost of the investment.

Job Incentive Board Program (JIB)

As an alternative to the State ITC, a firm could choose the JIB program. This program also provides a tax credit against the State franchise tax. It is a hybrid program, incorporating features of an ITC and an ETC. To qualify for the program, a firm must both undertake a new investment and increase the level of employment. A firm can benefit from the program for up to 10 years.

$$\text{Total Tax Saving from a JIB} = 10 \quad \frac{\frac{\Delta E}{E} + \frac{I}{C}}{2} \quad \text{Franchise Tax}$$

where ΔE represents the change in level of employment, E the original level of employment, I the value of new investment, and C the value of the original capital stock before the new investment took place. The total tax credits can not exceed the value of the investment.

Subsidized Borrowing Costs

Job Development Authority (JDA) - The JDA program is similar to the Federal IRB and UDAG programs. The JDA provides low cost loans covering up to 40 percent of a pro-

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annual interest savings = i* (.4)I

Resource Allocation Effects of the Subsidy Programs

All of the subsidy programs discussed above reduce the cost of a resource. In the case of the ITC, IRB, UDAG, and JDA programs, the cost of using capital is reduced for the firm. That results in significant resouce allocation effects. These programs favor capital intensive industries in general and will result in encouraging firms in all types of industries to substitute capital for labor.

The ETC programs have the opposite effect in that they reduce the cost of hiring labor. Consequently, those programs favor labor intensive industries and cause firms to substitute labor for capital. If all programs are used simultaneously, as they are currently, the net effect may be neutral in terms of resource allocation. This depends in part on whether one resource is reduced in price by a greater percentage than the other resource.

The resource allocation effects are important in terms of the success of the EZ program. It is assumed here that the major objective of the EZ program is to revitalize inner cities and to create job opportunities for disadvantaged workers. Those two objectives would imply that for the EZ to be successful the tax credit for disadvantaged workers in particular and the tax credits for employment in general should take precedence over the ITC, IRB, and UDAG programs.

In particular note that all tax credit programs are nonrefundable. It is possible that the ITC programs in conjunction with the 10 percent general ETC could reduce all of a firm's taxes. The ETC program for hiring disadvantaged workers would therefore be redundant. That defeats one of the major objectives of the EZ program.

In addition, from a firm's point of view, they should be indifferent between receiving an ITC or an ETC as long as the credits are of equal dollar value. So why not then favor programs? The ITC program should be dropped and the ETC programs expanded in order to further the objective of employing more workers in general and more disadvantaged workers in particular.

Mr. NOWAK. Thank you very much. Let me, doctor, ask you a couple of questions. You had made a study of the various benefits that you alluded to.

For small business and startups, could you elaborate on the pure tax code incentives for that new entrepreneur. How far down the line? You know, we talk about 2 or 3 years before he can generate a profit, and so forth.

Mr. GANLEY. I think that from local studies that I have either worked on or reviewed, that most new firms do not gain any direct benefit from either direct investment tax credit or employment tax credits for probably the first 3 years of existence. In some instances firms may not truly be earning a sufficient amount of profit for their first 5 years of existence to really gain any direct benefit from any type of tax credit. That situation was actually accelerated by the changes in the tax code during 1981 with the new depreciation schedules that were put into place and recategorization of different types of equipment, buildings, it means that the Federal tax liabilities that a small business firm is liable for, or any business which is capital intensive or equipment intensive at all, probably would take anywhere from a period of 2 to 3 years before there was a real relevance to utilizing economic development incentives such as employment tax credits.

Mr. NOWAK. The need for seed capital either from EDA or the other funding mechanisms that are in existence, probably could be dovetailed into the tax incentives that we are talking about.

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But the administration has not endorsed that—or those sections which would provide these incentives. In fact, as you know, the EDA is still on the cutting block of OMB and will be facing that struggle.

I had recently talked to some bankers and we were looking at the kinds of credit allocations that are available out there across the board, including small business. They stated that money is still somewhat tight and in fact when I asked them the question, do you keep statistics as to how many people come in for a loan of one kind or another, either for a large ticketed item like a car or refrigerator or a small business loan, and how many people are refused, they said that they are running about a 64-percent refusal rate.

I would assume that those first startup businesses would be involved in that kind of a category denial and that is really the reason why to some degree we emphasized seed capital in this bill to try to provide some alternative means for them. The jobs tax credit that you mention, I would assume could be carried forward so to some degree, even though the direct benefit doesn't come the first year. If they could carry themselves through that initial period, it would provide some internal cash flow availability in later years, at least for those that succeed.

And I agree also with your comment about the training. It seems to me essential that we use whatever means is now available to bring together a comprehensive plan. In many areas, of course, we have started the private industrial council training program which is another subsidy to the employer to take on the task which most of the time is a very expensive task, of training people, displaced or otherwise. This program, whether it be for 3 months or 6 months or a year, promises a private sector long-term job. I know that we have done it with welders, mostly from Bethlehem Steel displaced people, and we have got Kittinger with carpenters and cabinetmakers being retrained. I would envision if this zone were in place, that that PIK could grow through one means or another with Federal funding to provide the same type of training that would be needed for these businesses. If the existing strong, large businesses can't do it, certainly these younger businesses wouldn't be able to do it.

Do you have any other thoughts on how that employment training could be provided, or how we take that worker and provide enough incentive for him to want to be retrained and be put into such a program as we describe.

Mr. GANLEY. I heard Congressman Kemp speak earlier. It is very clear that the motivation to work is one of the strongest motivations that we find around us, that thousands of people will line up when there are opportunities to submit an application for a handful of jobs.

Mr. NOWAK. It was ironic, I just had a call from Anaconda and I want to share this with the panel, that they had received for expansion an industrial revenue bond loan and to some degree that was subsidized. But the expansion went on and there was a very large capital investment, and out of that had grown the requirement for 36 jobs, as they had projected. So, you know, they are going to put the little ad in the paper, and hope they can pick up some people who are interested in these jobs. And the day that

they did it, he had called me back that morning and told me about the experience of coming to work at 7:30 in the morning, and hoping that they could find 36 people to fill not very glamorous jobs, but walking to his office, or driving to the office and seeing these lines of people down the streets some, as they counted, 10,000 people waiting in the rain all night to get that first application in. So there is no question that people want jobs. The real problem as I see it is where we are going to get the jobs? Even if we have the ability to retrain, really what are we going to retrain for? Where are those jobs going to come?

Mr. GANLEY. One of the interesting things we found out back in 1977, as you know, the Buffalo economy was much healthier at that time, than it is now. Nevertheless, it was still just moving out of the recession of 1974, 1975, and 1976, unfortunately it was still quite high at that time. And at that time Bethlehem Steel made a major reduction in the work force Despite that fact, a major reduction in the work force by—at that time, still the major employer in the western New York area, and despite the fact that the local economy was just slowly moving back out of the last recession, in doing a labor market study and talking directly to business firms, talking to the chief executive officers of a series of firms, we were able to identify occupations and industries in which growth was going to take place. I think that the very successful training program that you mentioned before, was a direct result of the ability to identify a shortage of workers, despite the fact that there was a major disinvestment going on in the area. The fact that there wasn't a very effective use of Federal employment training funds at that time, and to this day that the private industry council needs as much well-documented information about employment opportunities that are going to exist in western New York is very clear-cut. The opportunity for worker-employee ownership firms probably is going to play a much greater role in the future of economies that have suffered the loss or decline of major industries. And I think that the provision which is provided in legislation takes that into account and answers that opportunity. We are going to have to have a better understanding, not just of where existing businesses are going to be expanding despite the economic conditions of the country and of western New York and areas like that, but also we need to identify those new business opportunities to begin to enhance the skills and the transition of displaced workers into new skill areas without having a clear cut idea of whether or not there is going to be a sufficient amount of jobs, I think, puts a great strain on the players and the programers who are out there hitting the bricks every day to attempt to get well devised skill enhancement programs going on. And the sooner that any of the bills that are being put forward take that into account that the way we gather information about employment opportunities is done on a national basis and that those don't necessarily lend itself to clean-cut analysis for the purposes of identifying new training programs, how many people ought to be in them, the nature of the skills that are going to be—so that if not a particular firm a series of employers, at least have the prospect of hiring people, is probably essential.

Mr. NOWAK. Let me at this point call on our colleague from Virginia, Mr. Olin.

Mr. OLIN. Thank you, Mr. Chairman. I really enjoyed your talk, Mr. Ganley and I am particularly looking forward to reading your paper which looks very scholarly and ought to be very interesting.

I take it that you would—I should ask you, the observation I have had on this training front is that if you take an existing business that is supporting itself, that business never has any trouble training employees. There are plenty of people who want to come to work. They find a way internally to get the training done and as far as the governmental function goes, trying to get those businesses a lot of extra help through tax credits to get people trained, doesn't create jobs. It just gives them money. Would you basically agree with that statement?

Mr. GANLEY. In essence, the idea of being able to provide funds for new training opportunities, has to be differentiated from the notion of merely providing funds internally—to do something which a business firm would take upon itself anyway.

Mr. OLIN. But if you had a business that was changing its product line, and they needed to train some people on new work, by and large they will take care of that and get that done. Now, a new business just starting, it of course can use help in getting people trained in a line of specific skills. As a matter of helping it with its operating costs, it helps get it off the ground through basically a subsidy. If you had training money spent in that nature, I take it you would agree that it would help a new firm get off the ground.

Mr. GANLEY. Provided there is at least sufficient working capital to give it some opportunity to succeed. There could be no guarantees and the—through the profit incentive that you are going to guarantee anybody a profit. You certainly can provide some assistance.

Mr. OLIN. I wan't sure I got your point right at the beginning of your talk. You were talking about where the weight should be put in trying to help new businesses, and I think you emphasized the employment tax credits in the early part, and I thought you said at the end that these tax credits really wouldn't help a new business for quite a few years, until it began to get enough profit to apply the credit to. Prior to that time, the credit really is just the bookkeeping entry.

Mr. GANLEY. I think the point I am trying to make is that if you are going to have a series of tax incentive-based economic development tools, and the goal is in fact to generate new jobs or expanding job opportunities, in any local labor market, the weight has to be directed at the employment side of that tax credit picture.

Mr. OLIN. You are looking toward trying to encourage labor intensive businesses that way, as opposed to investment intensive——

Mr. GANLEY. Yes; I think it is a major point that any business firm is going to look at not just a series of tax credits, but what it actually needs to do business. And a capital intensive firm certainly can take advantage of any of the variety of tax credits that already exist or are being currently proposed.

However, if you are primarily concerned with the revitalization of areas that have gone through longer term economic clime, and

you have large numbers of people who really do not have the opportunity nor desire to move elsewhere in the country, that you have to begin to provide that series of incentives most likely to encourage more labor intensive types of businesses.

Mr. OLIN. OK. I appreciate that point.

I want to ask you another question and I don't want it to sound the wrong way because I am really interested in trying to find practical ways of improving this situation. I want to be sure that we put our money into something that is going to do some good.

In your studies of the formation of small business in New York State or wherever else you have done your research, have you been able to establish any kind of correlation between businesses that survived or prospered as a result of having been the recipients of various programs of the kinds we are talking about, as opposed to businesses that some enterprising person got in charge of and drove like the devil and succeeded without really a lot of outside help of a governmental nature? Did you draw any generalities of that type, or have you got any data that would bear on that?

Mr. GANLEY. I think the only data that I am really familiar with that even takes that into account is in some of the data generated through the various programs of assistance in the minority business development area. Various types of assistance programs have demonstrated those firms who receive various types of assistance who are likely to succeed than those who are either unaware or don't have the ability to define what type of assistance they need. It is very clear to me, without being an economist, I don't think I need that hat at all, that any business gets and is successful primarily because someone was able to identify a decent business opportunity, was excited enough and was hard-driving enough to grab the whole thing by the horns, run with it and accept a hell of a lot of risk.

Mr. OLIN. We all know that those people are the ones who tend to succeed as opposed to a different type of person, and that factor is extremely important, it is almost overpowering. Some people you can give all the help in the world and it doesn't really do you much good in the long run.

Mr. GANLEY. I have had the opportunity, and it is not part of any academic scholarly work per se, but the opportunity in the center that we run at the college. It is a similar experience that I have discussed with people running equivalent institutions, at other universities and colleges: That on an ongoing basis people literally call and come in the door on a weekly basis. They will come to—almost any conference that you run that sounds as if it is going to give them some more knowledge, to advance what you are trying to do in terms of managerial skills. I am struck by one obvious consideration that I have seen in the last 3 years that any time we offer programs or we sit down on a 1 to 1 basis with potential entrepreneurs, that the primary difficulty faced by them, regardless of what industry that they are hoping to operate in or what particular type of business endeavor they are seeking, to start an enterprise in, is that the inadequate amount of information they have pertaining to financial resources area creative financing. I know that numerous successful small business people have a tendency not to want to get involved with government agencies of any form,

even when in fact those government agencies might be able to provide them both assistance of a financial and technical nature.

Mr. OLIN. Are you saying then that the programs that we are talking about really ought to be sure we have in those programs sufficient knowledgeable counseling for new people going into business and maybe that realistic good counseling would be worth more, in some cases, than monetary, direct monetary help?

Mr. GANLEY. I do think though that one of the problems faced by anyone looking at equity or credit markets is the great difficulty of trying to induce investors to even take a look what the risk is. It is one thing to talk about regional venture capital and there is no question that venture capital is growing by an enormous magnitude and has for the last 10 years, and appears to be going to grow. The match up though between that venture capital and the growth of venture capital and the smallest of entrepreneurs, is not an easy one. It is much easier to sell someone the idea of a new product line that seems to fit within the overall investment trends of the stockmarket than it is to get someone to invest in a small service business——

Mr. OLIN. I don't want to prolong this, but do you have suggestions in the area of how do you improve that match up? How would you go about doing that in terms of a legislative plan that we are trying to work out?

Mr. GANLEY. I think that part of the investment strategy approach has to have strong participation with a full set of actors in the local financial community. That's not to say that they are the only people with a sufficient amount of knowledge to assess what is going to go on. There is a saying that they are the only actors in the game who can readily identify where the credit or where the potential investors are. The technical assistance can take you so far, and then you must have some direct access to the financial community and their willingness to participate. I know in Buffalo, N.Y., there tends to be a good amount of cooperation between the venture capitalists, the banking community and the economic development agencies. One of the things that I worried about in terms of successful long term revitalization of the area, is the stripping away of economic development administration funding for the economic development agencies because part of the success that has gone on there has been tied to the ability to use some of that funding and match it up with bankers and venture capitalists and make things go.

Mr. OLIN. Thank you very much.

Mr. NOWAK. Thank you very much, Mr. Olin. I think Mr. Olin makes a good point, and I have seen some statistical information regarding specific SBA programs and the failures and bankruptcy rate that was generated. But I don't believe we really have a good correlation between the available statistical information and the private companies affected.

In trying to think through your question, this brings me to NFIB testimony of last year where they talked about what problems a small business has getting started, and one certainly in the forefront of all that was a lack of management ability. Dr. Ganley here has just mentioned, too, the informational problem because the depth of investigation into a business was not sufficient. Whether

it be financing or sales or marketing and the leap was taken before that total investigation was done. I would tend to believe financing all of the other problems are related to a lack of basic information. Perhaps we will have our staff do some research in that area to try to correlate that statistical information and the NFIB remarks of last year, and they will be here shortly to give us more information on that so-called management function. Really, they had to learn how to run a business first.

Mr. OLIN. Mr. Chairman, if I could add a point to that. I had some experience in Roanoke, Va., over the last 10 years with an agency called the Southwest Virginia Community Development Fund. They obtained money and they started up over a period of 4 or 5 years, six or seven small businesses, one of which I was quite interested in, because I was supplying it with work, making harnesses, and it was interesting, and I didn't have much time to spend with it, but it was interesting over the years to watch these companies; they all finally failed. All the money that was put into them, I don't know what it was. It was probably $200 to 300 thousand was put into these companies, partly from the banks and partly from the government, but the thing that was really missing, they didn't have any trouble getting people. They did by and large good work, but the management skills were missing. We had trouble getting the managers of those small businesses that were good enough, that were tough enough, you know, had enough guts and push, and the fact that they were getting all this help didn't really do them much good, because they sort of laid back and they were hoping everything would work out. You and I know, businesses don't work that way.

I think in any kind of program that we are thinking about, we've got to really be sure that we have thought through what kind of support services in terms of expertise is really needed to go along with the money or the subsidy. Otherwise you may end up with a lot of activity, but a lot that doesn't come to much.

Mr. NOWAK. You certainly need the management information to initially start that business.

Mr. Dalton.

Mr. DALTON. Doctor, I would like to ask one question and that is that in the course of your presentation you mentioned the need for communities to develop an investment strategy and in the course of developing one to come up with a plan and do some planning.

How much planning are you really looking at there? I mean, there is only so much you can do with a closed steel mill. Unless you are going to knock it down and then turn around and take the 100 acres and turn it into merging land, if you will, to put up 5 other, 10 other buildings on it.

Mr. GANLEY. My notion of planning regional development: To what extent, should we be able to identify those firms which have potential for some growth, depending on what types of funding is available, depending on credit conditions, both regionally and nationally. I think you need to look at some analysis of what the history of the particular industries in question in your region of the country have done. It is very clear, if you look at the area that I am most familiar with, that you had historically two major types of employers that were generating a lot of jobs, and through not just

a quick set of decisions, but really over a period of 20 years or so, those decisions punitively met an incredible reduction in the employment opportunities.

It seems to me that had the whole idea of doing some economic development planning been put in place, on a regional basis, 20 years before, some of that could have been anticipated and some of the problems faced by regions of the country now which have had severe economic dislocations might still have occurred, but they could have been anticipated to some degree and you could have had a more effective use of resources coming into the area. And that's the type of plan I have been talking about. I don't think it is in anybody's self interest to set up a whole series of planning goals and objectives that must be reached for a region. I don't think that that will necessarily work.

I do think the priorities of employment opportunities and what is going to happen to the work force as there is a shift in economic demand for different types of products has to be taken into account. I would like to point out that the economic development function in Erie County and the city of Buffalo is a relatively new entity, since around 1976. It has grown and has been institutionalized in that area relatively rapidly. Other areas of the country, as you know, already had been doing that. I think that Congressman Nowak, Congressman LaFalce, were very instrumental in insuring that that type of planning that I am talking about actually is taking place now. It is true, that you can't do very much with a closed steel mill if the firm in question already has determined that it is not marginally profitable enough to maintain production there. And it is also true that the economic development authorities have very limited capacity to do something with a closed down steel mill except perhaps find ways of utilizing the assets on a smaller scale—interest investors in it.

But I do think that there are other types of opportunities, once you have some sense of priorities and planning in that context, to allow you to most effectively use the resources that might be coming from private groups, from community groups, and really get a much greater participation of workers, perhaps, anticipating what is going on and looking perhaps for some type of worker participation in ownership. That is not necessarily is solution for any particular situation. It is that type of planning where there is a greater degree of involvement that really requires a planning process to exist to begin with.

Mr. DALTON. Is that type of planning better done on a city or county level, or are you looking more at say a multicounty region.

Mr. GANLEY. I think it probably depends on the size of the region. It seems to me that—it probably was done on some type of regional level. That regional level may just exist in one county, say several villages and towns. In other areas it may in fact require the—you are talking about a six or an eight county region. I think it depends on the scale of employment and business in an area, how dependent an area is on major producers and employers, how diversified it is. Probably the more diversified it is, the broader can be the scale of any kind of planning mechanism.

Mr. DALTON. Thank you, Mr. Chairman.

Mr. NOWAK. Thank you very much and Dr. Ganley, I want to thank you for coming down and sharing your experiences with this committee and giving us your outlook on the concepts of enterprise zones. I want to again thank you for coming down from Buffalo.

Mr. GANLEY. Thank you, sir.

Mr. NOWAK. Our next witness will be Bruce Hahn, who is a manager of government affairs and has been with the National Tooling and Machining Association serving that industry for, I believe, approximately 5 years. He earned his MBA degree from George Washington University, and in addition to his responsibilities there, serves as a secretary of the Small Business Legislative Council.

Mr. Hahn, it is a pleasure to have you before the committee once again, and I want to thank you at the outset for your patience.

TESTIMONY OF BRUCE HAHN, MANAGER, GOVERNMENT AFFAIRS, NATIONAL TOOLING & MACHINING ASSOCIATION

Mr. HAHN. Thank you, Mr. Nowak. I appreciate it. I do have a bit of a time problem. I wonder if I may just submit the testimony for the record.

Mr. NOWAK. Without objection, so ordered.

Mr. HAHN. Our problem is somewhat different than most of the industries right now who are beset by the recession and whose business economies are in bad shape and whose former workers are the displaced workers that this committee is discussing today.

Our problem has been a chronic shortage of skilled labor. The skills of our industry are among the highest in the world. It takes about 4 years to turn an apprentice into a journeyman and is a very expensive proposition. The investment is typically $40 to $60,000. Productivity of an apprentice is relatively low during the early stages, it costs a whole lot as the apprentices work with journeymen who have to be taken off projects to train them.

And as a result this chronic shortage has actually hampered the expansion of the industry. Most of the time, our people are facing tremendous shortages. When we hit recessions like this, rather than having a surplus, what happens is typically the production workers go down from 55 hours a week to more normal work weeks, somewhere around 40. But nevertheless, the shortages will show up again in the recovery cycle as they are starting to right now. There are a number of points in your legislation which we think will encourage more training in our industry. Among them, are the allowance of a 50-percent jobs tax credit for hiring qualified displaced employees, as well as the 5-percent tax credit on the wages earned from business in a distressed area.

In addition we support the increase in an expensing allowance on property purchases up to $50,000 and a 10-percent investment tax credit on construction of new buildings, the allowance of an additional $400,000 of used property to be eligible for the investment tax credit. We think this will be particularly beneficial to start up businesses who typically buy more used equipment than the larger companies who typically buy more new equipment. The 25-percent investment tax credit for renovation of buildings older than 20

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years old would be very beneficial as would be the refundable investment tax credit with a ceiling of $250,000.

The 10-percent investment tax credit for increasing payroll expenditures over base period would be helpful as would the allowance of the $20,000 individual and $40,000 joint deduction for investors purchasing stock in small business.

That is a summary of the parts of the bill that we strongly support. Thank you

[Mr. Hahn's prepared statement follows:]

Prepared Statement of Bruce Hahn, Manager, Government Affairs, National Tooling & Machining Association

MY NAME IS BRUCE HAHN. I AM MANAGER OF GOVERNMENT AFFAIRS FOR THE NATIONAL TOOLING AND MACHINING ASSOCIATION. OUR ASSOCIATION REPRESENTS THE TOOL, DIE, AND PRECISION MACHINING INDUSTRY. THE INDUSTRY IS COMPOSED OF 14,000 INDEPENDENT CONTRACTING MANUFACTURING PLANTS, ALMOST ALL OF WHICH ARE SMALL BUSINESS CONCERNS EMPLOYING APPROXIMATELY 300,000 HIGHLY-SKILLED WORKERS. THESE COMPANIES BUILD SPECIAL TOOLS, DIES, JIGS, FIXTURES, MOLDS, GAGES, SPECIAL MACHINES (AUTOMATION, ROBOTICS, AND PRODUCTION LINES), AND PRECISION MACHINED PARTS OR COMPONENTS. THEY USE A WIDE VARIETY OF EQUIPMENT AND PROCESSES, INCLUDING MOST MACHINE TOOLS FROM THE SIMPLEST LATHE TO THE MOST COMPLEX NUMERICALLY-CONTROLLED MACHINING CENTER, ELECTRICAL DISCHARGE MACHINING, ELECTRICAL-CHEMICAL MILLING, AND ELECTRON-BEAM WELDING. THEY COMMONLY ACHIEVE TOLERANCES OF ONE-TEN-THOUSANDTH OF AN INCH AND REGULARLY USE COMPUTERS AS AN AID IN DESIGN, MACHINING, AND CONTROL OF OPERATIONS.

WE WOULD LIKE TO EXPRESS OUR SUPPORT FOR THE ENTERPRISE DEVELOPMENT AND INDUSTRIAL REVITALIZATION ACT OF 1983. THE PROVISIONS OF THIS LEGISLATION WILL NOT ONLY REVERSE THE INCREASED ECONOMIC DETERIORATION OF MANY OLDER URBAN AREAS, BUT WILL ALSO GREATLY EXPAND THE ABILITY OF SMALL BUSINESSES TO CREATE NEW JOB OPPORTUNITIES AND REDUCE UNEMPLOYMENT IN THE UNITED STATES. WE

SUPPORT IN PARTICULAR THE ALLOWANCE OF A 50 PERCENT JOBS TAX CREDIT FOR HIRING QUALIFIED DISPLACED EMPLOYEES AND THE PROFIT SHARING INCENTIVES CREATED BY A 5 PERCENT TAX CREDIT ON THE WAGES EARNED FROM THE BUSINESS IN A DISTRESSED AREA.

THE CREATION OF AN ENTERPRISE DEVELOPMENT LOAN PROGRAM TARGETED TO BUSINESS INVESTMENT BY FIRMS LOCATED IN DISTRESSED AREAS WILL DO MUCH TO STIMULATE ECONOMIC REVITALIZATION. THE FUNDING OF A SUCCESSOR TO THE ECONOMIC DEVELOPMENT ADMINISTRATION WILL ENABLE SIGNIFICANT LOAN AUTHORITY FOR THE EXPANSION OF SMALL BUSINESSES.

THE TAX PROVISIONS ARE ESPECIALLY HELPFUL TO SMALL BUSINESSES PRESENTLY STRUGGLING IN OUR WEAK ECONOMY. THE INCREASE IN AN EXPENSING ALLOWANCE ON PROPERTY PURCHASES OF AN ADDITIONAL $50,000 WILL BE OF GREAT ASSISTANCE IN STIMULATING INVESTMENT IN NEW BUSINESSES. LIKEWISE, A 10 PERCENT INVESTMENT TAX CREDIT ON CONSTRUCTION OF NEW BUILDINGS WILL NOT ONLY AID THE DEPRESSED CONSTRUCTION INDUSTRY, BUT WILL ENCOURAGE UPGRADING TO MORE PRODUCTIVE PLANTS AND FACILITIES. THE ALLOWANCE OF AN ADDITIONAL $400,000 OF USED PROPERTY FOR THE INVESTMENT TAX CREDIT WILL ENABLE THE SMALLER UNDER-CAPITALIZED FIRMS SOME MEASURE OF EQUALITY AS COMPARED TO THE LARGER COMPANIES WHICH MORE TYPICALLY BUY MOSTLY NEW EQUIPMENT. THE 25 PERCENT INVESTMENT TAX CREDIT FOR RENOVATION OF BUILDINGS AT LEAST 20 YEARS OLD WILL DO MUCH TO

ENCOURAGE THE MODIFICATION AND IMPROVEMENT OF STRUCTURES IN THE OLDER AND MORE DEPRESSED ECONOMIC AREAS. A REFUNDABLE INVESTMENT TAX CREDIT WITH A CEILING OF $250,000 WOULD DO MUCH TO LESSEN THE SEVERITY OF ECONOMIC DOWNTURNS ON SMALL BUSINESSES. A 10 PERCENT INVESTMENT TAX CREDIT FOR INCREASING PAYROLL EXPENDITURES OVER A BASE PERIOD AMOUNT WILL ENSURE THAT BUSINESSES ARE ENCOURAGED TO CREATE MORE JOBS AND DO THEIR SHARE IN PUTTING THE COUNTRY BACK TO WORK. FINALLY, THE ALLOWANCE OF A $20,000 INDIVIDUAL AND $40,000 JOINT DEDUCTION FOR INVESTORS PURCHASING STOCK IN SMALL BUSINESSES WILL CREATE A NEW STIMULUS FOR GROWTH IN THE SMALL BUSINESS SECTOR. THIS PROPOSAL WILL DO MUCH TO COMPENSATE FOR THE ECONOMIC DISADVANTAGE SMALL BUSINESSES FACE IN ATTEMPTING TO RAISE CAPITAL. UNLIKE THE LARGER COMPETITORS, IT IS USUALLY IMPOSSIBLE OR IMPRACTICAL FOR A SMALL BUSINESS TO ISSUE STOCKS OR BONDS AND YET THE SMALLER COMPANY MUST ALSO BORROW AT A HIGHER RATE THAN ITS LARGER COMPETITORS.

WE THANK YOU VERY MUCH FOR THIS OPPORTUNITY TO GIVE OUR VIEWS ON THIS EXCELLENT LEGISLATION. I WILL BE MORE THAN HAPPY TO ANSWER ANY QUESTIONS YOU MIGHT HAVE. THANK YOU.

Mr. NOWAK. Thank you, Mr. Hahn, for your summary.

When we tried to look at this industry's problem, it brought to my mind at least, the Private Industrial Council's training program in specific industries. I wondered if your companies had had any experience with the PIC council anyplace, and if you found that helpful? Could you see any way that we could start training people to have a sufficient pool of trained labor once this recession picks up enough to turn it around so you extend the production in your industry?

Mr. HAHN. We have been involved in training on an industry basis for about 20 years. We were originally training under funded programs under the Manpower Development and Training Act, which was later succeeded by CETA and now by the training bill passed last year.

We have had something like a 100-percent placement record, or very close to it, from the people who have successfully completed those training programs. As you know, the new training bill ties in closely with the PIC's. Our experience with PIC's is that, in some areas, they are extremely active, they are extremely constructive, and they do a very good job. I think that with the new provisions of the training bill passed last year, we will probably see them tied more closely.

In others, however, they are weaker, and they have not contributed as much. We are strongly encouraging our people, many of whom are already very active in PIC councils, to get involved even more.

Mr. NOWAK. The 50-percent tax credit you had mentioned is a possible help. Would this be meaningful in terms of taking somebody in in this category?

Mr. HAHN. Yes, I think it would. I think a lot of displaced workers can be trained for this industry. But one of the problems with such things as the targeted jobs tax credit, for example, is that when you talk about a relatively modest sum, $1,000 or $1,500 or something like that, as a tax credit against the actual cost of training, the investment of $40,000 to $60,000 of equipment, the fact that you are going to have a worker who is taking the time or the experienced journeyman, a small tax credit is not an effective stimulus. They will train without that being a factor if they can afford to train.

However, a tax credit of the magnitude offered in this bill, I think, will probably be in the range where you are going to encourage much training that otherwise would not have occurred.

Several things do need to be recognized. When you talk about a highly skilled type of a job, you are talking about certain innate characteristics that are required to be able to perform it. I looked at some of the blueprints that second-year apprentices do and I can't fathom a lot of them. So you have to allow some testing so that you can bring on board apprentices who are qualified, who have the innate mathematical abilities to be able to master the skill. They can be retrained, certainly, and a lot can be done, but they have to have certain inherent mental abilities to be able to get in. But that leaves a lot of room for many, many displaced workers to be retrained.

Mr. NOWAK. The basic educational requirements, I assume, are being done for your industry by some high schools and some community colleges; is that correct?

Mr. HAHN. In addition to our training programs, which we have had for about 20 years—we are, incidentally, working on a new training program which the industry will fund itself totally. Training is also done in the vocational education community and at junior colleges. What we fear is that, even with all of the resources we can bring to bear on the problem, it is going to fall short. Much like the PIC Councils, in some areas, the community colleges make a major contribution to training; in other areas, our training programs seem to be carrying the load; in some areas, the vocational education programs seem to be carrying the load.

Mr. NOWAK. Do you take the graduate of the high school? Is that the level where your training program would come into play?

Mr. HAHN. Yes. We actively seek, and we have programs that we send around to local high schools to encourage people to get into the tooling and machining profession.

Mr. NOWAK. What do you see as competitive pressures in your industry and on your members due to this shortage of skilled labor?

Mr. HAHN. One of the things that is kind of ironic is that, in many cases, we seem to be the training ground for the large corporations. We will take a young person out of high school and put him through the apprenticeship program and spend thousands upon thousands of dollars to train him, and he will be attracted from the small business that trained him to a major corporation who is willing to match the salary and give considerably more fringe benefits.

Mr. NOWAK. I see. Thank you.

Mr. Olin.

Mr. OLIN. I enjoyed your testimony. I really don't have any other questions. Thank you.

Mr. NOWAK. Once again, because of the time pressures, we will excuse you.

Mr. HAHN. Thank you.

Mr. NOWAK. Thank you very much for your patience.

Our next witness is an old friend who has worked with the committee before, Mr. John Motley, who represents the National Federation of Independent Business. He has been the deputy director of the Federal legislation of the NFIB. He has been with the organization approximately 10 years and has appeared before this subcommittee and many others in Congress to testify on many issues.

We welcome you once again, John, and appreciate your patience and the expertise that you have not only given this committee, but I speak of many other committees in Congress as well. We are glad to have you.

TESTIMONY OF JOHN J. MOTLEY, III, DEPUTY DIRECTOR OF FEDERAL LEGISLATION, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. MOTLEY. Thank you, Mr. Chairman and Mr. Olin.

First of all, I would like to start out by commending this committee for the continuation of these hearings that you started last year. Even though, in the end analysis, NFIB and the committee may not agree 100 percent on all of the recommendations that you come out with, we do believe that this is an extremely important area to continue looking into and, more important, for you to continue to focus the attention of Congress on these hearings on the job-creating capabilities of small business so that worthwhile public policy can come from this body.

A lot of my testimony today tends to be statistically connected, prepared by our research department. I do intend to go into testimony and read part of it, since I am a little unfamiliar with it.

But before I do that, I would like to make a couple of points. First of all, to follow up on the question that Mr. Olin asked Dr. Ganley, on the impact of tax credits for small businesses, and especially small business startups. I think that, in general, we certainly would agree with Dr. Ganley's answer, although there is one type of tax credit that I think would be very beneficial to a new business startup. That is a tax credit against payroll taxes which a firm has to pay whether it is profitable or not.

NFIB has recently polled its membership on the old idea of a general jobs tax credit, which I think you know they have opposed in the past. This time, we put it a little differently, that it was a general jobs tax credit against payroll taxes, and the membership has turned around and supported it. Not very heavily, but it is the first indication that they would be willing to take a look at this type of solution. Payroll taxes, if you are looking especially at labor-intensive firms, are just a tremendous burden.

That would bring me to the second point that I would like to make. That is that I think if you are going to be concentrating on new businesses and new business startups, in whatever the geographical area you decide upon, you got to take a look at public policy in general. I have come to the belief over the years that public policy is pretty much stacked against new business startups in this country.

Let me just tick off a couple of areas, and this is unprepared so if you have any questions or want any amplification on this later on, I would be glad to get it for you.

Let's just take a look at those payroll taxes. A new firm starting up—and we know that new firms create most of their jobs in their first 5 years of existence—must pay an ever increasing payroll tax burden. Between 1970 and 1990 in this country, we have 35 scheduled payroll tax increases. During that same period of time, payroll taxes for an average employee making, say, $18,000 a year will go from roughly $500 a year to $2,500 per year.

This is frightening enough, but if you take a look at the types of programs which are funded by payroll taxes in this country, they are all in trouble. Congress, when it looks at trying to do something with these problems, the immediate reaction is, of course, to raise the tax, which I think is extremely counterproductive if you are looking at labor-intensive jobs in the economy.

In addition, one of the programs that we use payroll taxes to fund unemployment compensation, tends to discriminate against smaller firms or new startups because they have no experience

rating. So what happens in a lot of States is, when they go in, they are given the highest experience rating, which means that they pay the largest possible tax in the beginning.

Let me address the complexity of our laws, especially in the tax area. Let's just concentrate on one. We dealt in the last Congress with depreciation rules and regulations—whether it was from the Republican side or the Democratic side—was an attempt to simplify, which most of the small business community was very much in favor of. That can be said to be true of all of the other areas and in particular, the inventory accounting area in which you have been deeply involved, and even the income tax area. It is essential for a business, to take advantage of all of the breaks that are in the law, to go out and hire a lawyer and an accountant, and new firms can't do this. So we are discriminating against them by the complexity of the code that we have.

Part of the testimony that I am going to be delivering is going to deal with some regulated costs which are very high on the problem areas that small businesses face. Regulated costs tend to discriminate against small firms dramatically. I think it is probably no surprise to anybody that small firms have a terrible time getting insurance at reasonable rates. You have this whole problem where, if you didn't have 10 employees, you simply couldn't purchase group insurance, whereas a larger competitor could go out and not only purchase group insurance, but because of the size of the group, tend to get it at much reduced rates.

Utility rates are pretty much the same thing. I think the electric utility ratemaking study that we did a couple of years ago and have given to the committee, and which hearings have been held on, proves without a doubt that small firms in a lot of areas are used to subsidize rates, not only for consumers, but for large firms.

Last, but not least, you can take a look at the whole area of government regulation. We passed a bill a couple of years ago or you passed a bill and we helped a little bit with it; that is Reg. Flex. But we exempted some major agencies from that, and one of them is IRS. You are in a situation where you have small firms having to comply again with very complex rulemaking, paperwork procedures, that general firms of a much more mature nature and with a lot more employees have a great deal of difficulty with also.

So I would simply make the overall point with those very, very inadequate examples just off the top of my head, that public policy is stacked against new business startups in this country, and it is no wonder that half of them fail.

So I would strongly urge the committee to take a look at what I would consider to be counterproductive public policy as you continue these hearings on job creation and on new business startups.

Mr. Chairman, if I could, I would like now to go to page 2 of my testimony and get into some of the statistical information that our research department has provided here and has analyzed. I think the committee is familiar with NFIB's Economic Report on Small Business. It has been in existence for roughly a decade now, and is used rather extensively, not only within the Government, but by all of the media when they need instant analysis of what is happening to the economy.

In addition to that, we have provided you again with information based upon that report that NFIB did in November 1981, which is a report on "Small Business in American Cities." If you would like, I can submit an additional copy for the record.

Last, but not least, we have just finished a much more in-depth report on "Small Business Problems and Priorities." I see that counsel has a copy of it already. This is a draft. It hasn't been printed yet. But we believe that it is our most extensive attempt to date to really find out what the problems are out there in the American small business community. We discussed this a couple of weeks ago, Mr. Chairman, and, at that time, you had some questions about the methodology. I think you will see on the very first couple of pages, 2, 3, and 4, that the methodology of the survey is discussed at length.

With that, I will be picking it up on page 2, with the section entitled "Small Business—Still the Job Generator."

With one brief contradictory interlude, the evidence has continued to mount that small business was the job generator of the 1970's. And while one can always question whether the past is prologue or, in this case, whether the change is cyclical or secular in nature, the trend appears to be continuing into the 1980's, despite the problems of the small business dominated construction industry. It seems clear, therefore, that any policy designated to promote creation of jobs must account for the behavioral patterns of smaller firms.

Not all small businesses are responsible for the role of small business as the Nation's job generator. In fact, research indicates that role is contingent on performance of approximately 10 to 15 percent of the population. The problem from a public policy perspective is that no means exists *a priori* to identify the specific firms that will fall in this job generator class. Compounding the public policy problem is that those groups of firms which seem to provide the job generators, i.e., very small and new starts, are those least susceptible to direct influence by the government.

NFIB has attempted to continually monitor small business problems through its survey program. The Quarterly Economic Report for Small Business, for example, has followed the single most important problem of small firms for nearly 10 years. Small Business in America's Cities looked at a series of problems among new and small businesses in the Nation's cities in the early 1980's. However, the most comprehensive study of its kind, "Small Business Problems and Priorities," was conducted late last fall and is scheduled for publication by mid-May.

It is important to note that while each of these studies has a different focus or emphasis, there is a basic consistency woven throughout. The same problems and concerns gravitate toward the top of any problem list, and the same problems and concerns gravitate toward the bottom. Obviously, an abrupt change such as the Arab oil embargo or rocketing interest rates creates a change in small business owner attitudes. However, resolution of the problem returns attitudes to more normal settings.

Chart 1 graphically illustrates the four problems which have usually been cited as the single most important problem by more small businesses than any other on a quarterly basis between Jan-

uary 1979 and January 1983. Note that "Inflation" as a single most important problem tracked the rate of inflation. The same was true for "Interest Rates-Financing." "Poor Sales" began its sharp rise less than 1 year ago as the compounding effects of the longest recession since World War II became clearer. Finally, "Taxes" as a single more important problem is somewhat inversely related to inflation and interest rates as problems, but finds consistent mention of between 10 and 20 percent.

While chart 1 only provides data for the last 4 years, data for the prior 6 are similar. When inflation was high, as it was during a large portion of the period, the number of small business owners citing inflation as the single most important problem was high. The only substantial difference was that interest rates-financing tended to remain at relatively low levels, and the second energy shortage brought shortages of fuels, materials, and goods, temporarily to the fore.

Differing from the data in a time series such as the one just presented, both the cities and priorities reports provided one-time snapshots, but a greater depth to the problems evaluated. The problem rankings of each are presented in tables 1 and 2. In comparing the two tables, there are a few points to be made. The first is obvious. The former contained 25 problems and the latter 72. As a result, the priorities study is more comprehensive. The second point is that while the cities surveyed contained only respondents from urban areas, the priorities survey incorporated those from rural and small towns. However, with the sole exception of employee-related problems, which were evaluated as far more serious by urban small entrepreneurs, there was little difference in responses among urban and rural small business owners. Thus, the differences in sample populations appeared to make little difference.

There were a number of striking results from the priorities study which make it particularly relevant to today's hearing. First the problems which tended to cluster toward the most severe end could loosely be classified as regulated costs. Of the first seven problems listed on table 2, four are clearly regulated costs, and two others are at least strongly influenced by regulatory agencies. The interesting point is that, from the Federal perspective, the most serious problems identified by small firms were interest rates, natural gas regulation or deregulation, and payroll taxes, which have been legislatively increased twice in the last 9 months. On the other hand, insurance, electric and telephone rates are State regulated, even though Federal antitrust actions obviously will influence the latter.

At the bottom of the problem list were a class of difficulties one could loosely term "public services." This rough class of problems included such potential difficulties as good highways and roads, adequate parking or public transportation, local promotion of local business, police and fire protection, et cetera. And while the Northeast and industrial Midwest are the regions of the country generally considered in the greatest need of replacing public facilities, the priorities studied provided no evidence that small business owners in the old industrial areas felt the need for improved facilities any more than did those in other areas. Of the old industrial States examined—New York, Pennsylvania, Ohio, Michigan, Indiana, Illi-

nois, and Wisconsin—only the evaluation of good highways and roads by Illinois entrepreneurs gave any hint that such problems are regionalized or important.

New firms—not confined to starts—did not register frequent and substantial differences from the population as a whole. Advertising capacity, poor sales, cost of facilities, and obtaining short-term loans were more severe for new firms than others. These data merely reinforce the cities study, which identified poor initial sales, financing, learning to run a business, and a good, affordable location as the most serious problems for small business starters.

A second striking point was that the nature of severity of problems encountered by rapidly growing firms and rapidly declining firms are often similar. The odd man out, at least in terms of problem severity, is the relatively stable, slightly growing firm. From a public policy perspective, these data imply the least stable firms are those with the greatest employment potential. It also implies that any public policy designed to aid these firms will result in considerable direct losses as well as considerable windfall. However, the windfall can be further leveraged, meaning the public policy incentive is not necessarily lost.

Mr. Chairman, I would include something like the general jobs tax credit in this area. One of the criticisms that was leveled at that by the Carter administration was that it was a windfall for firms which were growing anyway. That was, to a certain extent, true. But what happened when one of those firms took that credit—and let's remember that it was only a credit on newly created employment and not to replace employees—was they took that money and they leveraged it into other areas to continue their growth, expansion, purchase inventories, or whatever it might be. I think this is the point that Mr. Dennis is making in this testimony.

A third major point is that the primary differences among small business problems are across industries. Thus, what may be particularly useful as a stimulative or incentive in one industry would be of minimal utility in another. The transportation sector is particularly illustrative in this regard. While regulatory matters as a problem group fall in the middle range of small entrepreneur concern, it moves toward the top among owners of small transportation and communication firms. For example, cost of Government required equipment/procedures was ranked 39th by the total population, but 16th among those in the transportation sector. Any public policy intended to stimulate a particular industry must recognize its peculiarities and redress any unique problems which may exist.

I would put some of the problems which were mentioned by the previous witness in exactly this category. There is no doubt—our surveys indicate—that there is a real problem in getting skilled employees in industries such as this, but I don't think that we can assume that that is across the board in the small business sector.

In conclusion, Mr. Chairman, nothing will impact small business and its job generating capacity more favorably than will economic recovery. Various compensatory programs not only pale in contrast, but, more often than not, detract from the recovery itself. Therefore, it seems clear that, from a Federal perspective, a contin-

ued reduction in interest rates and noninflationary growth is public policy priority.

Over the longer term, it is clear that relative wage cost has a major impact on unemployment levels, particularly among the young. Thus, when Government artificially inflates the price of labor through increases in minimum wages, increases in payroll taxes, maintenance of Davis-Bacon, et cetera. It simply chooses to reduce the relative number of people employed and the opportunities available for new and small businesses. The contradictions inherent in public policy such as those noted continue to baffle small businessmen and women.

But obviously, there remains a missing element. By process of elimination, we conclude that element must be training of some kind. NFIB has little expertise in this area and, therefore, can offer little in this regard. The training, however, will have to address the very understandable inherent social problems of the psychological blow to the 50-year-old steelworker averaging $25 an hour who, when retrained, can do no better than half that, or the 25-year-old who has yet to develop useful attitudes toward work.

Thank you, Mr. Chairman, if there are any questions, I will be glad to answer them. Certainly Mr. Dennis would be more than happy to answer in writing any particular questions you might have on any of the surveys we have used in the testimony.

[Mr. Motley's prepared statement follows:]

PREPARED STATEMENT OF JOHN J. MOTLEY III, DEPUTY DIRECTOR OF FEDERAL LEGISLATION, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. Chairman, NFIB, on behalf of its more than half million small and independent business owner members, appreciates this opportunity to express our views on impediments to small business job generation. Today, we intend to spend the majority of our presentation sharing some of the information we have collected over the past few years on small business and its problems rather than offering detailed commentary on HR 2375 and/or related measures.

Long-Term Employment Strategy

The unemployment rate remains above 10%. By post World War II standards, that rate is high no matter how one approaches the figures. But it must be remembered that the employment demands made on our economic system during the 1970's as a result of the "baby boom" and the changing role of women was nothing short of incredible. In fact, between 1970 and 1980, the civilian labor force grew by over 24 million people, or 29%, compared to 13 million (19%) in the 60's and 7 million (10%) in the 50's. Considering these numbers, the surprising part was the number of people the economy was able to absorb, not the number it couldn't.

The economy will receive some relief during the 80's due to demographics. Further, the evidence seems to be gathering that the long-awaited recovery is underway. The result, therefore, is the need to adopt an approach to unemployment designed to meet tomorrow's requirements, not yesterday's. That means the old problem of structural unemployment must be returned to the front burner and the "accelerated" (not necessarily new) problem of reabsorbing workers from declining industries must be recognized. Neither is easy to resolve, for they often involve social as well as economic change, but each is the relevant problem that needs addressing.

Small Business - Still the Job Generator

With one brief contradictory interlude, the evidence has continued to mount that small business was the job generator of the 70's. And while one can always question whether the past is prologue, or in this case, whether the change is cyclical or secular in nature, the trend appears to be continuing into the 80's despite the problems of the small business dominated construction industry. It seems clear, therefore, that any policy designed to promote the creation of jobs must account for the behaviorial patterns of smaller firms.

Not all small businesses are responsible for the role of small business as the nation's job generator. In fact, research indicates that role is contingent on the performance of approximately 10-15% of the population. The problem from a public policy perspective is that no means exists a priori to identify specific firms that will fall in this job generator class. Compounding the public policy problem is that those groups of firms which seem to provide the job generators, i.e. very small and new starts, are those least susceptible to direct influence by government.

Small Business Problems

NFIB has attempted to monitor continually small business problems through its survey program. The Quarterly Economic Report for Small Business, for example, has followed the "single most important problem" of small firms for nearly 10 years. Small Business in America's Cities looked at a series of problems among new and small businesses in the nation's cities in the early 80's. However, the most comprehensive study of its kind, Small Business Problems and Priorities, was conducted late last fall and is scheduled for publication by mid-May. (The subcommittee has been provided a copy of the text for its use.)

It is important to note that while each of these studies has a different focus or emphasis, there is a basic consistency woven throughout. The same problems and concerns gravitate toward the top

of any problem list, and the same problems and concerns gravitate toward the bottom. Obviously, an abrupt change such as the Arab oil embargo or rocketing interest rates creates a change in small business owner attitudes. However, resolution of the problem returns attitudes to more normal settings.

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Chart 1

Single Most Important Problems

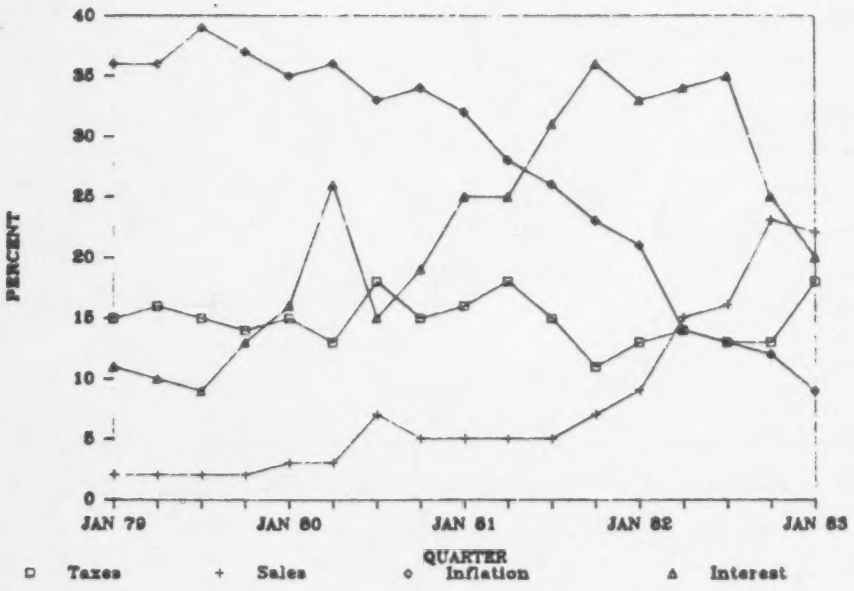

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Table 1

RANK ORDER, MEAN SCORES AND STANDARD DEVIATION
OF 25 SMALL BUSINESS PROBLEMS

Problem	Rank Order of Mean Score	Mean Score	Standard Deviation
Interest Rate	1	2.35	1.47
Cost of Insurance	2	2.49	1.23
Cost of Energy, Utility Bills, etc.	3	2.66	1.27
Cost of Labor	4	2.75	1.24
Local Tax Rates	5	2.87	1.22
Locating Qualified Employees	6	2.87	1.37
Cost of Supplies/Inventory	7	2.92	1.33
Cash Flow	8	2.95	1.34
Low Profits	9	2.99	1.29
Crime Rate	10	3.19	1.39
Competition from Large Firms	11	3.22	1.13
Workers' Compensation	12	3.31	1.44
Insufficient Sales	13	3.44	1.25
Controlling Inventory	14	3.49	1.32
Ability to Cost-Effectively Advertise	15	3.51	1.40
Employee Turnover	16	3.57	1.23
Obtaining Needed Loans	17	3.71	1.37
Cost of Rent	18	3.89	1.27
Lose Skilled Employees to Large Firms	19	3.91	1.23
Local Inspections and Inspectors	20	3.96	1.14
Ease in Getting Licenses/ Permits	21	4.00	1.20
Employee Relations and/or Unions	22	4.03	1.13
Unfavorable Business Location	23	4.22	1.08
Access to Highways, Roads, Parking, Public Transit	24	4.23	1.09
Garbage Collection	25	4.37	1.06

January, 1979, and January, 1983. Note that "Inflation" as a single most important problem tracked the rate of inflation. The same was true for "Interest Rates-Financing." "Poor Sales" began its sharp rise less than one year ago as the compounding effects of the

longest recession since World War II became clearer. Finally, "Taxes" as a single most important problem is somewhat inversely related to inflation and interest rates as problems, but finds consistent mention of between 10%-20%.

While Chart 1 only provides data for the last four years, data for the prior six are similar. When inflation was high, as it was during a large portion of the period, the number of small business owners citing "Inflation" as the single most important problem was high, etc. The only substantial difference was that "Interest Rates-Financing" tended to remain at relatively low levels, and the second energy shortage brought "Shortages of Fuels, Materials, Goods" temporarily to the fore.

Differing from the data in a time series such as the one just presented, both the Cities and Priorities reports provided one-time snapshots, but a greater depth to the problems evaluated. The problem rankings of each are presented in Tables 1 and 2. In comparing the two tables, there are a few points to be made. The first is obvious; the former contained twenty-five problems and the latter seventy-two. As a result, the Priorities study is the more comprehensive. The second point is that while the cities survey contained only respondents from urban areas, the priorities survey incorporated those from rural and small town areas. However, with the sole exception of employee-related problems, which were evaluated as far more serious by urban small entrepreneurs, there

Table 1

Severity of Small Business Problems

Problem	Rank	Mean	Median	Stan Dev	% Terming Problem "Critical"
Interest Rates	1	2.79	2.41	1.63	26.3
Cost of Liability Insurance	2	2.96	2.75	1.52	18.4
Cost of Natural Gas. Gasoline, Fuel Oil	3	3.04	2.78	1.62	19.3
Telephone Rates (Costs)	4	3.11	2.97	1.43	12.8
Cash Flow	5	3.13	2.93	1.62	19.0
Cost of Property and Casualty Insurance	6	3.17	2.99	1.53	14.7
Electricity Rates (Costs)	7	3.17	2.93	1.63	16.6
Payroll Taxes	8	3.44	3.15	1.65	12.5
Poor Earnings (Profits)	9	3.56	3.36	1.71	15.0
Projecting Future Sales Changes	10	3.57	3.30	1.54	8.3
Federal Business Income Tax	11	3.59	3.30	1.64	10.6
Federal Paperwork	12	3.66	3.39	1.46	6.0
Highly Variable Earnings (Profits)	13	3.66	3.38	1.66	10.5
Unreasonable Government Regulations	14	3.73	3.57	1.59	8.5
Locating Qualified Employees	15	3.74	3.45	1.68	10.3
Delinquent Accounts; Customer Financing	16	3.75	3.56	1.70	11.2
Bad Debts and/or Bankruptcies	17	3.76	3.61	1.67	10.4
Employee Benefit Costs	18	3.78	3.48	1.67	8.8
Cost of Inventory/ Supplies	19	3.90	3.74	1.58	6.0
State/Local Paperwork	20	3.91	3.80	1.43	4.5
Competition from Large Businesses	21	3.93	3.90	1.67	8.6
Training Employees	22	4.01	3.91	1.53	4.9
Controlling My Own Time	23	4.03	3.99	1.54	5.0
Fixed Costs Too High	24	4.07	4.17	1.62	6.7
State Business Income Tax	25	4.09	4.07	1.66	6.9
Ability to Cost-Effectively Advertise	26	4.17	4.27	1.66	6.2

Cost of Outside Business Help	27	4.20	4.23	1.52	3.2
Finding Out About Regulatory Requirements	28	4.21	4.38	1.54	4.8
Poor Sales	29	4.24	4.63	1.62	7.4
Cost of Facilities (including Rent and/or Mortgage Costs)	30	4.26	4.43	1.61	5.8
Keeping Up on Business and Market Developments	31	4.31	4.34	1.44	2.8
Collecting Sales and/or Excise Taxes for Government	32	4.32	4.62	1.71	7.6
Low Worker Productivity	32	4.32	4.60	1.57	5.7
Obtaining Good Supervisory Personnel	34	4.36	4.86	1.70	6.1
Sales Too Dependent on Health of One Business or Industry	34	4.36	4.96	1.75	8.5
Locating Business Help When Needed	36	4.50	4.78	1.49	3.4
Sales Too Seasonal	37	4.50	4.92	1.57	4.9
Obtaining Long-Term Loans	38	4.51	5.17	1.70	7.9
Cost of Government Required Equipment/ Procedures	39	4.52	4.96	1.58	5.0
Death (Estate) Taxes	40	4.53	5.21	1.70	7.4
Getting Useful Business Information	41	4.53	4.71	1.43	2.3
Pricing Goods/Services	42	4.56	4.85	1.45	2.3
Getting Information on Government Business Assistance Programs	43	4.63	5.20	1.55	4.0
Cost-Effective Mail Service	44	4.64	5.20	1.53	3.4
Obtaining Short-Term Loans	45	4.67	5.42	1.60	5.9
Applications for Licenses, Permits, Etc.	46	4.69	5.11	1.44	2.7
Handling Business Growth	47	4.70	5.14	1.43	2.0
Controlling Inventory	48	4.71	5.15	1.41	1.9
Shoplifting, Pilferage, Bad Checks, etc.	49	4.84	5.42	1.41	2.9
Fair State/Local Inspections	50	4.89	5.42	1.32	1.9

Local Promotion of Local Business	51	5.05	5.66	1.37	2.4
Losing Skilled Employees to Large Firms	52	5.07	5.67	1.38	2.5
Obtaining Investor Financing	53	5.09	5.75	1.52	5.0
Locating Satisfactory Suppliers	54	5.10	5.63	1.29	2.3
Good Highways and Roads	55	5.15	5.73	1.38	3.1
Selling to the Federal Government	56	5.16	5.77	1.43	3.4
Fair Federal Inspections	57	5.20	5.67	1.18	1.0
Street Crime	58	5.21	5.70	1.25	1.8
Shortages of Materials, Goods, Fuel, etc.	59	5.22	5.69	1.20	1.1
Selling to State/Local Government	60	5.24	5.77	1.32	2.5
Anti-Competitive Practices, e.g. Price Fixing	61	5.26	5.79	1.37	3.7
Adequate Parking or Public Transportation	62	5.28	5.79	1.28	2.1
Shipping or Receiving Shipped Goods	63	5.33	5.74	1.12	0.9
Competition from Imported Products	64	5.35	5.84	1.32	3.3
Littered or Unattractive Business Area	65	5.37	5.77	1.15	1.6
Police and Fire Protection	66	5.38	5.79	1.13	1.2
Poor Business Location	67	5.47	5.84	1.01	1.1
Employee (Labor) Unions	68	5.49	5.86	1.19	2.8
Competition from State or Local Government	69	5.52	5.88	1.12	1.8
Competition from Non-Profit Organizations, e.g. Universities	70	5.55	5.88	1.08	1.6
Competition from the Federal Government	71	5.62	5.91	1.03	1.6
Garbage Collection	72	5.64	5.89	0.90	0.7

was little difference in responses among urban and rural small business owners. Thus, the differences in sample populations appeared to make little difference.

There were a number of striking results from the Priorities study which make it particularly relevant to today's hearing. First, the problems which tended to cluster toward the most severe end could loosely be classified as "regulated costs." Of the first seven problems listed on Table 2, four are clearly regulated costs and two others are at least strongly influenced by regulatory agencies. The interesting point is that from the Federal perspective, the most serious problems identified by small firms were interest rates, natural gas regulation or deregulation, and payroll taxes, which have been legislatively increased twice in the last nine months. On the other hand, insurance, electric, and telephone rates are state regulated even, though Federal anti-trust actions obviously will influence the latter.

At the bottom of the problem list were a class of difficulties one could loosely term "public services." This rough class of problems included such potential difficulties as "Good Highways and Roads," "Adequate Parking or Public Transportation," "Local Promotion of Local Business," "Police and Fire Protection," etc. And while the northeast and industrial mid-west are the regions of the country generally considered in greatest need of replacing public facilities, the Priorities study provided no evidence that the small business owners in the old industrial areas felt the need for improved facilities any more than did those in other areas. Of the old industrial states examined, New York, Pennsylvania, Ohio, Michigan, Indiana, Illinois, and Wisconsin, only the evaluation of

"Good Highways and Roads" by Illinois entrepreneurs gave any hint that such problems are regionalized or important.

New firms (not confined to starts) did not register frequent and substantial differences from the population as a whole. Advertising capacity, poor sales, cost of facilities, and obtaining short-term loans were more severe for new firms than others. These data merely reinforce the Cities study, which identified poor initial sales, financing, learning to run a business, and a good affordable location as the most serious problems for small business starters.

A second striking point was that the nature and severity of problems encountered by rapidly growing firms and rapidly declining firms are often similar. The "odd man out," at least in terms of problem severity, is the relatively stable-slightly growing firm. From a public policy perspective, these data imply the least stable firms are those with greatest employment potential. It also implies that any public policy designed to aid these firms will result in considerable direct losses as well as considerable "windfall." However, the windfall can be further leveraged, meaning the public policy incentive is not necessarily lost.

A third major point is that the primary differences among small business problems are across industries. Thus, what may be particularly useful as a stimulative or incentive in one industry would be of minimal utility in another. The Transportation sector

is particularly illustrative in this regard. While regulatory matters, as a problem group, fall in the middle range of small entrepreneur concern, it moves toward the top among owners of small transportation and communication firms. For example, "Cost of Government Required Equipment/Procedures" was ranked #39 by the total population, but # 16 among those in the transportation sector. Any public policy intended to stimulate a particular industry must recognize its pecularities and redress any unique problems which may exist.

Conclusion

Nothing will impact small business and its job generating capacity more favorably than will economic recovery. Various compensatory programs not only pale in contrast, but more often than not detract from the recovery itself. Therefore, it seems clear that from the Federal perspective, a continued reduction in interest rates and non-inflationary growth is the public policy priority.

Over the longer-term, it is clear that relative wage cost has a major impact on unemployment levels, particularly among the young. Thus, when government artificially inflates the price of labor through increases in the minimum wage, increases in payroll taxes, maintenance of Davis-Bacon, etc., it simply chooses to reduce the relative number of people employed and the opportunities available

for new and small businesses. The contradictions inherent in public policy such as those noted continue to baffle small businessmen and women.

But obviously, there remains a missing element. By process of elimination, we conclude that element must be training of some kind. NFIB has little expertise in the area, and therefore can offer little in this regard. The training, however, will have to address the very understandable inherent social problems of the psychological blow to the 50 year old steel worker averaging $25/hour who, when retrained, can do no better than half that, or the 25 year old who has yet to develop a useful attitude toward work.

Mr. NOWAK. Thank you very much, Mr. Motley, for your testimony.

Certainly the "Small Business Problems and Priorities" by Mr. Dennis will be reviewed by the staff and the subcommittee. I think there is an awful lot of useful information in there, as we go through the exercise of trying to more closely solve the problems of the economy. All of the work that we do is really trying to target the role that small business can play if given an opportunity. Some of the impediments to that role, I think, are very usefully listed in the study. How we can attack one or more of those impediments is really a part of this hearing of the enterprise zone concept and what the administration has brought forward.

I can't help to think that some of the problems, from management function to marketing and adequate financing, and even—as was listed in the report—finding a good and affordable location to operate that small business, could be enhanced by the passage of this kind of legislation. Perhaps it would give more people the opportunity to get into small business and those who are in it to expand. From everything that I have seen, we would be able to perhaps not change too much whether it be regulation or another type of problem that is listed here, but at least it would give the incentive to somebody to look at a small business as a viable alternative to what is available out there in the marketplace now. Anything, I think, we can do to enhance that would be at least a broadening of that opportunity.

It seems to me that while the stock market has taken off and there is a lot of enthusiasm that the interest rates will stay down, we are still faced with some problems. You had mentioned the interest rates in your testimony and the inflationary rate. Congressman Kemp was testifying earlier this morning, and I asked him the question of the problem of taking some of these incentives that we have: the jobs tax credit, perhaps some seed money, taking a training program in some areas and subsidizing it and using the

PIC's, and bringing together all of these incentives, plus some management training and management analysis.

In the western New York area, we just had recently a university get together with CAL-SPAN, which is a research organization—the academics and some business community people—to try to give some direction and some expertise to that starting or expanding business person. Unless we can put that together, I don't see how we are going to expand those kinds of opportunities that are out there.

I wondered if you had any experience recently about new business being started, even with the problems that are out there for the newly starting business person?

Mr. MOTLEY. Mr. Nowak, reserving, so to speak the right to have Mr. Dennis correct the testimony for statistical accuracy—but if I am not mistaken, there were many, many more new businesses started in the 1981-82 recession cycle than there were businesses going out of existence. As a matter of fact, it seems to me that the spread was rather significant. I seem to recall a figure of a couple of hundred thousand, 250,000-plus new businesses being started—230,000, something like that—during a period which encompassed both years.

I don't know what to attribute that to. We have taken a look at it. It may be that times were bad and that people simply were out of work and they had skills, and that they decided that they were going to go out and try it for themselves.

Certainly you have some attributes to going into business in this country which are looked upon very, very favorably by most people and their neighbors. It is the way to go. It seems to be the only way toward upward mobility left. We ran out of land in the West, and we supposedly ran out of our safety valve, but I think maybe American small business is the safety valve for the population now. It allows us upward mobility.

So it is my impression that we had a great many new businesses which were created. But, again, the statistical evidence proves that half of those go out of business in the first 5 years of existence. That is due to a great variety of reasons, most of which can be in some way connected with the inability to manage the firm, as was mentioned here before.

It is awfully difficult to know the real reasons for it. Is inability to manage the firm the fact that you couldn't secure a loan? That can be based on so many different things—a poor presentation by you, inadequate background material, or tight money, or the fact that this particular bank doesn't want to lend to small business.

So I think we have to be careful when we start looking at reasons for firms going out of business. But there is no doubt that there is some sort of a management quotient in most of the reasons that are there.

Mr. NOWAK. We talk about the primary source of financing small business, the initial dollars from the entrepreneur himself and then, somewhere around 72 percent of bank financing alleged as providing the capital. Mr. Olin made a point of trying to correlate the kinds of programs that are out there, whether it be an SBA or an EDA or an industrial revenue bond program that provides some subsidy to the interest rate that is presently available, and the fail-

ure of those people using those types of programs as against those who have strictly their own capital invested.

I wonder if you have any statistical information or any knowledge of how many of your members go that route?

Mr. MOTLEY. I believe that we could provide you with at least a very slim statistical picture of the numbers of NFIB members who have been involved in certain types of programs. It is relatively small. As a matter of fact, when we did a soft data survey some time back on the Small Business Administration, almost half of the firms had basically never heard of it before, which tells you something.

I would simply make an observation again, with the caveat that we will go back to the research people and have them crack some numbers for you on some of this surveying that we have done in the past and see if we can come up with an answer.

Another observation is that Federal programs, and particularly the SBA, simply do not deal with a very large percentage of the small business community. I think the committee has used figures of 2 to 3 percent over the years. We have a lot more businesses than that coming into existence every year and living through the cycle. So I would think that, in any analysis that you would do, the results would be heavily weighted toward entrepreneurs who had an idea, found their financing, and got out and put it together.

I think you could also take a look at some of the rather poor results which have been received from some of the programs which were certainly well intentioned such as those in the minority area, and the rather intensive help that they have been provided to try to get them more involved.

So with that as a general observation, let me go back and see if we can provide any stronger statistical information for you.

Mr. NOWAK. One of the problems that has come up over and over again, and I am trying to figure out a way to work it into this whole bill, is the management function and how we can encourage those going into business to initially learn enough about the business before they are given financing or before they go out to raise that money to make sure that there is a high degree of probability they will have some success.

Do you have any thoughts on that? Has your organization looked at that? Do you think we could provide it through some kinds of peer groups?

Mr. MOTLEY. The last time that we looked at it in depth was during the period when we were involved in the debate over the creation of small business development centers, which we had some skepticism about, and still have some skepticism about, as far as an overall public policy in this area.

I guess we start from the premise that you can't make small business fail-safe. It is impossible. I think, all we can do is offer opportunities.

Let me say in addition that the Federal Government doesn't have enough money, or the State governments don't have enough money to make small business fail-safe out there. That is a budgetary problem that I think you have to face.

But I think for those entrepreneurs who may be looking for some sort of government assistance, you may be able to at least make

them aware that these programs are out there to help them and that very possibly their assistance might depend upon the fact that they do something to improve their management skills.

I would also mention that the peer pressure seems to have worked in certain areas. I can't cite you chapter and verse, but there are some Western States, and very possibly the State of Montana, where this has worked very well. I can also check that for you.

In addition, NFIB would have liked to have seen back at the start of the small business development center concept at least one private sector pilot program with such firms as Control Data. They have actually gone into various business areas to provide a whole series of management services for a fee. But we are talking about a considerable amount of money which was spent in creating small business development centers also. There could be some way to figure out whether the firm can afford the entire range of services which are available or whether that range of services should be offset by some of the type of money which is going into small business development centers.

We have not become convinced from what we have seen that that program is the ultimate answer. We are very impressed by the Small Business Institute program over at SBA, in which you actually have the graduate students working with businesses over there. It supposedly has a tremendous success rate, and the business people who have been involved in it have gotten a great deal out of it.

I really don't think that there has been a real concerted effort by anybody over the years to really utilize the volunteer work which is available. To my knowledge—and I haven't been involved in it first hand, but sort of observing it from the side—there has always been a debate going on in every administration as to just how much we try to encourage this volunteer help. Do we defer their expenses? Again, I have met small business people who would swear by the help that they had received from some retired executive.

One thing that they have always said is that the person has got to be in the same type of business in order to help them. You can't send somebody in who was in manufacturing for all of his life and you are running a drugstore and expect to get some worthwhile help out of him.

But I get the feeling—and again, it is just a gut feeling from observing the scene for 12 years now—that nobody has ever really attempted to orchestrate that program to the point where you are really putting the resources where they are needed. And it should be particularly worthwhile in urban areas, because most of the chapters are associated with a regional or district office of SBA, which are located in the major metropolitan areas of the country.

Again, those are personal observations, and I have no statistical information to prove them.

Mr. NOWAK. Fine. We thank you once again. If we have any further questions, we will get back to either you or Mr. Dennis.

Mr. MOTLEY. I would just make one final comment, Mr. Chairman, and that is that I think as NFIB sits back and views this whole enterprise zone debate and participates in it, you know that

we have some votes from our membership which are not for enterprise zones.

There are a number of reasons for that which are easy to point out. If we asked Mr. Smith, who is on the committee, whether he would like to have a similar business such as his set up in the city of Trenton with all of these types of tax breaks and whatnot moving in and competing in his marketplace, I bet he would say, "My goodness, no. I don't know if we could survive." I think that is a natural reaction on the part of entrepreneurs.

I think the biggest problem that NFIB may have with the enterprise zone concept is that it focuses on geography, which we really don't know if it will be an effective place to focus. We know that small business creates jobs. We know that they are continuing to create jobs into the 1980's. Dr. Ganley said that may not continue into the 1990's, but the trend right now indicates that we are still creating most of the jobs.

We think that the focus should be on small business, at least from the Federal level, with the geographical focuses and everything else left to the people who are fairly close to the situation back in the State governments and the local governments and city governments who can decide where they want to focus their aid.

Mr. NOWAK. This 25 limitation, I can see that causing a problem as we try to decide where those 25 locations are.

Mr. MOTLEY. Yes. I understand there are an awful lot of people who are planning to make a lot of money out of lobbying to where those 25 locations are going to be.

Mr. NOWAK. We are looking at unemployment, and when you do look at that, you get led into the small business area. Then, on the other hand, you also have the unemployment statistical information which will lead you into various locations if they are high enough. Certainly an overall problem is going to be to try to designate those areas which are highest, which give you impact. Even though it is thought by some that revenue "losses" are minimal, that may also be a problem as we deal with OMB and Treasury in trying to formulate a piece of legislation.

You have just mentioned here, I think, a key concern, or it will be when people realize the kinds of impacts that could come out of this.

Mr. Foley mentioned earlier that if Youngstown gets it and Warren doesn't, what are going to be the ramifications there of people perhaps moving their businesses to take advantage of these incentives, although we would like everybody in a high unemployment area to take it and erase all the unemployment and spur small business to greater heights.

But it seems to me to give the administration a great deal of power and also to impose unduly competitive problems upon areas of the country that we are trying to help the most, the most depressed areas.

Do you have any thoughts on all of that in general?

Mr. MOTLEY. I think that the NFIB comes from the position that if the problems that are inhibiting small business are great enough to be treated, or an attempt to eliminate them or lessen them in general geographic areas, maybe we should spread that attempt

out and try to encourage job creation in the small business countrywide.

Very possibly, on the other side, look at the types of programs that are out there for job training and for economic development, which are already in place and can be changed and focused. There is an attempt in the Small Business Act authorization to focus ever more assistance on labor surplus areas—which we probably will have a problem with, too, because we have an awful lot of firms which don't reside in labor surplus areas. It may be appropriate to take the programs which are in existence and either refocus or put more money into those efforts, but at the same token, to keep in the back of our minds that, if we really want to address the problem of employment in our country, that we should try to eliminate the obstacles that are there for all small busnesses at the same time.

Maybe we could combine both focuses. At least we would certainly like to see it done that way.

Mr. NOWAK. Again, thank you very, very much.

We will adjourn the meeting and keep the record open for further testimony.

Thank you.

[Whereupon, at 12:55 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

APPENDIX

NATIONAL COMMISSION FOR EMPLOYMENT POLICY
1522 K Street, NW, Suite 300
Washington, D.C. 20005

May 23, 1983

Honorable Henry J. Nowak, Chairman
Subcommittee on Tax, Access to Equity
Capital and Business Opportunities
B363 Rayburn Office Building
Washington, D.C. 20515

Dear Congressman Nowak:

I am writing to convey some observations on H.R. 2375, since a schedule conflict prevented Commission testimony on this bill at your hearings in April. In general, the intent of the bill to provide incentives to private sector employers is entirely consistent with the Commission's own policy orientation.

There are several specific points on which we have reservations:

(1) Approval of an enterprise development loan is to require "reasonable assurance" of employment opportunities to be created within 2 years. How will (or could) this be enforced? Unless monitored, which requires administrative resources, signing such an assurance is no guarantee of the outcome. (Earlier programs encountered problems with this sort of pledge.)

(2) Title III, Section 311 includes definitions of eligible areas. While we feel that actual or prospective dislocation is a good criterion, using a margin of 1 percentage point above the national unemployment rate would include many reasonably healthy areas. Unemployment rates tend to vary across areas on the basis of industrial structure. It would be possible for an area with a relatively high unemployment rate to be better off than an area with a rate below the national average but which contained a large number of low-paying and part-time jobs. Having a larger differential above the average will reduce, but can never completely eliminate, the problem.

(3) Paragraph (a) of Part IV, Section 401 establishes a tax credit equal to 10 percent of qualified increased employment expenditures. As we read the definitions, there is no assurance that increased employment would be responsible for the increased expenditures. The credit could be used to subsidize wage increases for a constant or even declining number of employees. I am enclosing a recent staff paper which provides some further background.

(4) Finally, we were glad to see a displaced worker credit defined on a basis consistent with the Job Training Partnerships Act's Title III, and with safeguards against turnover of workers merely to exploit the credit.

However, the availability of a credit based on declining percentages of wages over as long a period as eight years seems too generous. Since displaced workers almost by definition are persons with good work histories, the basic problem is finding new jobs. Firms would be likely to retain such workers without the subsidy in later years, once they are on the payroll.

I hope that these points will be useful to you. Please feel free to get in touch with me, should you have further questions.

Sincerely,

Patricia W. Hogue

PATRICIA W. HOGUE
Director

Enclosure

National Commission for Employment Policy

Everett Crawford

Policy Analyst

PRIVATE SECTOR JOB CREATION

EXECUTIVE SUMMARY

Wage Subsidies

- On-the-job-training has been a useful tool for both employees and employers, but does not always work well or easily during economic downturns.

- Tax credit programs (the WIN tax credit, the New Jobs Tax Credit, and the Targeted Jobs Tax Credit) have been effective in the past only to a moderate degree, in part because they have not been marketed agressively.

- A youth wage subsidy experiment, to induce school dropouts to return to school to complete their high school education, was authorized by the Youth Employment and Demonstration Projects Act of 1977. It produced a limited response from the business community. However, in a two-location subexperiment, employer's participation increased as the subsidy increased. About 1 out of 5 employers canvassed responded With a job. It is worth noting that job developers in this demonstration had had little previous experience in working with the private sector.

- The new targeted tax credit for youth, to take effect in the summer 1983, may be of help in addressing the youth problem if it is marketed properly, since it effectively allows employers to hire disadvantaged 16 to 17 year olds for 50 cents per hour. The summer youth tax credit would be available generally and would not be as limited geographically as the youth wage subsidy program. With active marketing it could produce more jobs.

Youth Subminimum Wage

- Studies of the subminimum wage for youth issue suggest that youth employment would increase if a subminimum were in effect. Estimates are that 180,000 to 720,000 jobs for teenagers (16-19) would be created if a 75 percent minimum wage were in effect. The potential for reducing youth unemployment through use of a subminimum wage is limited because the differential would likely attract new teenagers into the labor market.

- Because youth with the greatest unemployment problem tend to live in places where economic activity is low, a subminimum might not increase their opportunities.

Vouchers

- An NCEP-sponsored review of four voucher experiments, for the economically disadvantaged and the GI Bill for Vietnam veterans found that the voucher technique was not less expensive than traditional employment and training services. Both require administrative staff, counselors, and other support staff and the training periods tend to be longer and more expensive.

- The GI Bill for Vietnam Veterans, which served mostly better educated males, yielded significant gains for veterans who took advantage of the program, suggesting it might be a useful approach for some displaced workers.

- Training voucher experiments proved of limited value in increasing the labor market position of disadvantaged persons.

- There is no evidence that disadvantaged participants' occupational choices in voucher programs consistently enhance their employment and earnings opportunities.

- Vouchers targeted solely on the disadvantaged for on-the-job training or wage subsidies seem to be inappropriate and ineffective.

Targeted Economic Development

- Displaced workers and the economically disadvantaged generally share a common problem: They are located in distressed areas, where jobs are not readily available.

- Legislation exists that can promote new economic development but the link with educational and training programs is missing. JTPA is one possible avenue for such a linkage to occur. More adequately funded development programs coordinated with education and training would help the development process.

Background and Issues

Both the Congress and the Administration are looking for ways to bring down the unemployment rate. A wide variety of options are being considered. Among them are issues as to how to use public policies to expand employment in the private sector. While it is recognized that expansion of employment in the private sector depends critically on increasing economic growth, policymakers are exploring ways in which policies might be used to stimulate private sector hiring of specific groups.

Experience with Private Sector Policies and Proposals

Over the years the Federal Government has sought ways to expand employment in the private sector for both cyclically and structurally unemployed. Some of the attempts to involve the private sector in employment and training policies have focused on the private sector's participation in service delivery and policymaking. Others have focused on various forms of subsidies for wages and training and assistance for economic development.

In the late 1960s the National Alliance of Business was created to focus business attention on the employment needs of the disadvantaged and to help organize and provide staff for on-the-job training programs at the local level. More recently, in 1978, the Private Industry Councils were created to provide policy guidance and to exert business influence on CETA programs as part of a Private Sector Initiative Program. In the Job Training Partnership Act adopted last year, the Private Industry Councils were assigned dominant leadership roles in the planning and development of employment and training programs.

As a means of expanding employment in the private sector various forms of wage subsidies have been tried, as have other approaches including economic development. The purpose of this paper is to review briefly the experience with previous efforts, to outline what is known about the ideas and proposals that are currently being discussed, and to identify those policies that seem to show promise of helping to increase employment in the private sector.

For purposes of organizing this paper, the proposals and ideas are grouped as follows:

A--Wage subsidies
B--Subminimum wage for youth
C--Vouchers
D--Targeted economic development

The following sections review the experience and the outcomes of various policy initiatives in the areas enumerated above. The materials drawn on here include work done by or for the Commission and from staff study of other sources.

A. Wage Subsidies

Wage subsidies to employers can take several forms: (1) Vouchers* used to pay for a portion of a worker's wages or training, (2) on-the-job training agreements and, (3) tax credits of various kinds. These wage subsidies and a youth wage subsidy experiment conducted under the Youth Demonstration Projects Act are reviewed below:

1. On-the-Job Training (OJT). OJT has been part of the employment and training "tool kit" since the beginning days of the "active manpower policy" of the early 1960's. It is viewed by some authorities as the most effective method of providing training to people who are having employment difficulties. Under OJT an employer contracts to hire and train an eligible program participant for some period of time. In return, the employer is reimbursed some portion of the trainee's wages (usually 50 percent) to account for the trainee's lower productivity during the training period. There is a moral and a contractual, obligation to keep the worker on after the training is completed.

   OJT is considered a good approach to training, one that produces positive results for both trainees and employers. Employees (trainees) receive regular wages and training that is relevant to the work that they are doing. Despite its many advantages, however, OJT is not entirely without cost to employers and is not suitable to all forms of training. Moreover, as experience has shown, employer participation in OJT programs generally follows the business cycle, rising when business conditions are favorable, but falling again when there is a downturn in the economy. Administration of OJT contracting has been perceived by some employers as involving excessive amounts of "red tape" and this has influenced their decisions about participation, especially in tight labor markets. Additionally, the marketing of OJT candidates is time consuming and complex since it frequently involves developing training slots one at a time.

   An evaluation of the JOBS program, for example, found that it was quite successful in modifying hiring standards by adding "social and institutional pressure to that exerted by the tight labor market" so that female and minority group participants, in particular, were able to enter jobs in the primary labor market that were previously closed to them. Unfortunately, over the long run, many of these gains proved transitory as economic conditions soured in the late 1960's and the maxim "last hired, first fired" came into play. OJT has never been the preponderant form of training in Federal programs.[1]

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* Vouchers are reviewed separately in Section C, below.

2. Tax Credits. Experience with employment tax credits has been mixed. The U.S. has had employment tax credits since 1971. They are reviewed chronologically below:

   a. The WIN (Work Incentive Program) Tax Credit was adopted in 1971 as a proposed means of helping to stimulate employment for welfare (AFDC) recipients. Like the WIN PSE program of the 1970s, there has been little take-up of the subsidy by employers. The largest number of credits claimed during any one year was slightly over 50,000; during another 2-year period some 500,000 AFDC recipients entered the labor market, but only some 88,000 WIN tax credits (less than one-fifth of the total entrants) were claimed.

      Reasons for the low take-up of the WIN tax credit are varied. The reluctance of employers to hire welfare recipients is well known, but there is some belief that the credit was not marketed aggressively by the Employment Service and others responsible for WIN operations at State and local levels.

   b. New Jobs Tax Credit (NJTC). The NJTC was passed in 1977 as part of the economic stimulus program. In effect for only 1 year, it was an untargeted marginal tax credit designed to stimulate employment. The credit amounted to 50 percent of the increase on each employee's wage base above 102 percent of the previous year's wage base.

      How effective was the NJTC as an employment stimulant? While the Department of the Treasury reported that firms claimed $1.5 billion, an amount that implies approximately 1.1 million new jobs. Studies suggest that some of these jobs would have been filled without the help of the subsidy. Empirical evidence evaluated in a study by Dave O'Neill indicates that approximately the same rate of displacement exists under the wage subsidy program as under various Public Service Employment (PSE) schemes. Of the 1.1 million jobs claimed, between 300,000 and 500,000 jobs appear to have been actually new jobs created under the New Jobs Tax Credit program in 1977. Since the tax subsidy is about $1,200 per new hire, this implies a net budget cost of between $2,600 and $4,400 per job, an amount that compares favorably with the lowest possible estimates[2] of $6,200 direct cost per PSE job for the same period.

   c. Targeted Jobs Tax Credit (TJTC). TJTC was passed in 1978 and replaced the NJTC. It provided a credit of 50 percent of an employee's first year wages and 25 percent of the employee's second year wages (up to $6,000) for seven groups of eligible workers who were supposed to be experiencing some disadvantage in the labor market. The groups are: SSI recipients, the handicapped, under 35 Vietnam veterans, disadvantaged youth 18-24, exconvicts, recipients of State and local general assistance, and youth (16-19) in approved cooperative education programs.

During the period between March 1979 and the end of September 1980, some 300,000 TJTC certifications were issued. It appeared that about half of the certificates were issued for cooperative education students (not necessarily disadvantaged and not permanent jobs). More than half of the remaining 150,000 certificates were issued retroactively, i.e., for people already on the payroll, and not for new hires.

The TJTC was reauthorized in the Economic Recovery Tax Act of 1981; retroactive certificates were prohibited. Further changes in the TJTC were adopted in 1982. Among them was a provision for a tax credit for summer employment that is focused on economically disadvantaged youth aged 16 and 17. This credit will equal 85 percent of wages up to a total summer income of $3,000. Thus, if an eligible youth were employed at the minimum wage the net cost to the employee would be 50 cents per hour. This credit will first take effect in the summer of 1983.

One theme runs through the analyses of the several tax credits reviewed: They have not been marketed aggressively. The WIN credit was not marketed extensively nor was the NJTC. TJTC has not been marketed strongly by the Employment Service or by CETA prime sponsors.[3]

3. Youth Wage Subsidy Experiment. A Youth Entitlement Demonstration that sheds some light on the subsidy issue was authorized as part of the Youth Employment Demonstration Projects Act in 1977. Under the Entitlement project a guaranteed job (part time during the school-year and full time during the summer) was authorized for dropouts who agreed to return to and remain in high school. The demonstration was carried out in 17 school districts; seven were covered completely and 10 districts were covered partially. Program sponsors were authorized to enter into agreements with private, public and nonprofit employers to pay the salaries for the students assigned at the minimum wage (except in one multicounty sponsor area where 75 percent of the minimum wage was authorized).

   The sponsors had experience with canvassing public and nonprofit employers for summer and part-time positions for youth, but little with private employers. From the beginning of February 1978 through August 1980, the private sector provided slightly more work sites than the public and nonprofit sectors, but private employers averaged one student worker per site while the other sectors tended to have more than one participant per site.

   There was a demonstration within a demonstration in that two sponsors were allowed to vary the amount of subsidy to the private employers to see if this made a difference in employers take-up of the program. Subsidies were offered in these locations at 50, 75, and 100 percent of the minimum wage. It was found that the amount of subsidy did make a difference:

Subsidy Level	Particpation Rate of Employers Canvassed
50 %	4.7 %
75	10.0
100	18.2

Employers did respond more favorably to the larger incentive, but the demonstration raised doubts about the business communities' overall responsiveness to the needs of disadvantaged youth.[4]

Conclusion. The wage subsidies reviewed here include OJT contracts, tax credits, and a youth wage subsidy experiment. OJT has proven itself to be valuable to both trainees and employers, but it is sensitive to the business cycle and may not always be useful in economic downturns, especially if contract administration is not simplified. The tax credits that the Nation has tried have worked with varying degrees of effectiveness. The WIN Tax Credit was not used extensively; the New Jobs Tax Credit, in effect for only one year, was thought to be moderately successful; and the Targeted Jobs Tax Credit has had only modest success. Tax credits have not been marketed strongly and have failed in the past to produce new jobs because of retroactive certifications. Targeted tax credits that are publicized aggressively seem to be a useful tool. The new summer tax credit for disadvantaged 16 and 17 year-olds if marketed aggressively may be useful in attempts to reduce youth unemployment.

B. Subminimum Wage for Youth

Two proposals involving compensation for young workers are being advanced at the present time. The President has proposed a special summer minimum wage for young people at 75 percent of the minimum wage, or $2.50 per hour. In its report Agenda '83, the Heritage Foundation is taking a somewhat different approach; the foundation is proposing revisions to the Fair Labor Standards Act Regulations that permit the payment of less than minimum wages for "learners." Currently, the definition of learners is quite narrow. The objective of both proposals is to remove the barrier of the minimum wage so young people will have greater opportunities to find employment and acquire work experience.

While NCEP has not undertaken exhaustive research of the subminimum wage issue, it has examined research by others on the question. A basic conclusion of the research is that more youth would be employed if a subminimum was enacted. The estimates of the effect vary. Research shows that with a 25 percent decrease in the minimum wage for teenagers (16-19), their employment would be increased by one to four percent, or a range of 180,000 to 720,000 jobs. There is no way to measure the effects with absolute certainty, however. Researchers have identified a number of possible consequences.

The General Accounting Office has only recently released a report on minimum wage policy. The report reviewed extensively the work published in 1981 by the Minimum Wage Study Commission. While the findings of the GAO report are too extensive to be summarized here there are two points that stand

out: Economic research shows that there is some loss in employment with each increase in the minimum wage. The potential for reducing youth unemployment through use of a subminimum wage is limited because the differential would likely attract new teenagers into the labor market.

The Minimum Wage Study Commission recommended against establishing a youth subminimum wage. Its report lists several considerations that led to that conclusion. Among them are: The youth differential would likely draw more teenagers into the labor market; there is no evidence that areas with the highest levels of teen age unemployment would benefit from the differential (in the youth entitlement demonstration, discussed above, the location of private employers' place of business was a problem for the sponsors); and that there would be a tendency on the part of employers to substitute, where they could, less expensive youth for adult workers. This work was revised and published subsequently in the Journal of Economic Literature; it drew the same basic conclusions as the Commission's report.

Related to the subminimum wage question is a study published in 1981[6] that reports the results of a survey of more than 400 employers in Manhattan. While granting that Manhattan is unique, the findings were pertinent to this review. In general, the study found that businesses hire youth for a variety of reasons: they will take part time and flexible schedules, the employers are trying to appeal to a youth market, and youth workers provide a pool of potential trainees for more senior jobs. Only one reason given for hiring youth was related to the minimum wage--some employers hire young people because they will accept the minimum. Some other employers said they have not and will not hire youth. Those that did not hire youth were asked if a subminimum wage would sway them to hire more kids. The majority answered, "no." The reasons for this response varied, for example, where automobile insurance rates are prohibitively high, and youth are not hired as drivers, the business is one that is not trying to appeal to a youth market, the employer cannot work with flexible schedules.

Conclusion. Studies of the subminimum wage for youth suggest that more youth world be employed if a subminimum wage were enacted. Estimates for teenagers (employed at 25 percent less than the minimum wage) indicate that 180,000 to 720,000 jobs would be created. The new summer TJTC targeted on disadvantaged 16 and 17 yer olds might be an alternative for them.* Youth having the greatest unemployment problems are concentrated in places where there is little economic activity. For those who are eligible for it, the summer TJTC might be expected to stimulate more jobs because of the lower wage and the lower cost of employment for employees.

C. Vouchers

Vouchers are being looked to in some quarters as a means of helping to stimulate employment. The national experience that we have with vouchers involves programs of education, training, and wage subsidies. Proposals for using vouchering approaches in the manpower and employment fields go back at

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* Under the summer TJTC the effective hourly rate would be about 50 cents per hour against a $2.50 subminimum wage.

least as far as the anti-poverty effort in the mid-1960s. The success of the post World War II "GI Bill" provided a model for many of the proposals. Voucher approaches, i.e., giving an individual a certificate that can be used to purchase education, training, or pay for a portion of one's employment, are attractive intrinsically; vouchers allow the individual freedom of choice and do not require the creation of substantial government bureaucracies to administer them. In 1982, the National Commission for Employment Policy sponsored a study that reviewed the literature on what was known about voucher programs. That study resulted in a report that analyzed and synthesized the results of four voucher experiments and the GI Bill for Vietnam Era veterans.

The voucher experiments include (1) the Seattle-Denver Income Maintenance Experiment (SIME/DIME) conducted as part of a large negative income tax demonstration; (2) the Portland, Oregon, WIN voucher experiment; (3) a Portland OJT voucher experiment; and a Dayton (Montgomery County) Ohio, wage voucher experiment. These voucher programs and the post Vietnam GI Bill are reviewed below.

1. Seattle-Denver Experiment. This experiment was conducted between 1971 and 1977. Low-income individuals enrolled in the voucher experiment were permitted to attend the training program of their choice, with the experiment offering to pay for half or all of their training expenses, including tuition, books, transportation, and child care. (The fraction of expenses paid by the experiment varied by experimental plan.) The experiment offered an extensive and highly structured counseling program, which provided labor market information to persons who sought such assistance. The counseling was mandatory for persons who used the vouchers. The designers of the experiment expected that the training subsidies would induce enrollees to take additional training and that the extra training would improve enrollees' labor market positions. Although the vouchers were used by about 30 percent of the family heads eligible to use them and did cause these participants to take up to three extra quarters of formal schooling, a major disappointment of the experiment was that the extra training led to no appreciable increase in post-program earnings. On the contrary, there were significant drops in earnings while the voucher program was still in operation, which were not offset by later gains. This has led analysts to speculate that notwithstanding the elaborate counseling programs, the low income persons who opted to take training may have obtained schooling that was overambitious in light of their previous labor market positions.

2. Portland Experiment. The Portland demonstration took place within an operating WIN program. Since the project relied on existing WIN personnel to manage the voucher program, the demonstration provides a reasonable test of the ease with which vouchers can be introduced in a major employment and training program. All new WIN clients enrolled in Portland during the 4-month test period were eligible to receive vouchers. These vouchers could be used for up to 1 year of training in any public or private institution in the Portland metropolitan area. Clients were free to seek training in the occupation of their choice, provided there was a reasonable expectation of employment after 1 year of training. As in the Seattle-Denver

experiment, around 30 percent of the eligible clients used the vouchers, and there were no significant problems in implementing the program. Unlike the Seattle-Denver program, however, no significant earnings drops (or earnings gains) were observed in the participant population in comparison to previous WIN trainees, who obtained training under the traditional delivery system. The main difference between vouchered and nonvouchered training in the Portland program was that the former tended to be somewhat longer (by about 10 weeks) and more expensive than training received under the previous system.

3. Portland OJT Voucher. This demonstration was conducted in 1975 as part of the WIN program. The experimental vouchers provided a 50 percent wage subsidy for up to 1 year of OJT. There were no cost limits on training except that contracts providing subsidies in excess of $3,800 were subject to administrative review. The permissable length of subsidized training was dependent on the skill level of the occupation. During the demonstration period, 29 percent of all eligible new WIN entrants chose to participate in the OJT voucher experiment. Voucher holders were then supposed to locate private sector employers and negotiate training agreements, but only a small fraction of vouchered clients (19 percent) were able to conclude training agreements during the 6-week period for which their vouchers were valid. Most of the successful clients obtained their positions through the intervention of WIN job developers, rather than through their own efforts as was originally intended. It appears, then, that potential employers are reluctant to hire vouchered job applicants without some job developer screening and referral.

4. Dayton Wage Voucher. This experiment was conducted in 1980-81 by the local CETA prime sponsor as part of a larger job search assistance demonstration project. AFDC recipients referred by the local WIN program and General Assistance recipients were randomly assigned to three different types of experimental job search. Two of the experimental plans provided wage vouchers which enrollees were expected to use during their 8-week job search. The vouchers were worth up to $4,500 over a 2-year period to employers who hired the vouchered clients. The third plan provided no wage vouchers. As in the Portland demonstration, only a small fraction (13 percent) of vouchered clients succeeded in finding a job, and only a quarter of the employed clients worked for firms who bothered to apply for the wage subsidies. Even more striking, the group which was provided with no wage vouchers attained a significantly higher employment rate (21 percent) than the groups with vouchers. Apparently the vouchers hurt rather than helped vouchered job seekers' chances of finding employment, probably because the voucher stignatized the voucher holders by clearly identifying them as members of a high-risk, disadvantaged population.

5. GI Bill. The evaluation examined was a study of the utilization and effectiveness of GI Bill educational subsidies for Vietnam-era veterans (those on active duty between 1964 and 1975). GI Bill vouchers could be used for classroom and on-the-job training,

correspondence instruction, and certain other forms of training. Beneficiaries received flat payments which could be allocated by the veteran to training and living costs; the benefit level varied with the number of dependents and type of training. Training had to have a vocational objective. Training plans were screened by veterans claims examiners, and educational institutions selected by trainees had to be approved by the Veterans Administration. In large measure because veterans are typically far more qualified than the eligible population in Seattle, Denver, and Portland, a far higher percentage of eligible people (59 percent) used vouchers under the GI program. Based on earnings comparisons between veterans who did and did not take training, participation appeared to yield significant advantages, with participants earning approximately 10 percent more than statistically matched nonparticipants. Gains were found to be especially significant for those who took full-time training, and for blacks regardless of educational background. However, there is some question about the interpretation and generalizability of these findings. Participants and nonparticipants--even if matched on the Armed Forces Qualification Test (AFQT) scores--probably differed in motivation, health status, and other personal attributes, and the higher earnings of participants might be attributable to these factors.

The analyses of the voucher experiments do not show that vouchers are less expensive than traditional employment and training services. Administrative staffs, counselors and other support staff are required. And in the SIME/DIME experiments participants tended to opt for community college training which is more expensive than traditional training.

In this connection, it is interesting to note that in comparing the GI Bill with the other voucher approaches, there were some important differences. The veterans were predominately male and the better educated veterans were the ones who took advantage of the program. In the negative income tax and WIN demonstrations the participants were economically disadvantaged and there were larger numbers of females. Although the current high unemployment has affected all groups of workers, adult males have been particularly hard hit, and it is possible to draw some rough parallels between them and the veterans who took advantage of the G.I. Bill. Consideration might be given to the establishment of a voucher program for long term unemployed who have had a regular attachment to the labor market. Such a voucher could be used to purchase training, subsidize employment with private (or public) employers, or to pay for fringe benefits. In order to help insure that the voucher will have appeal for employers, active and high level marketing would be required.

It should be noted also that the GI Bill and the Seattle, Denver and Portland demonstrations used existing systems to make eligibility determinations and administer a voucher program. The GI Bill was administered through the Veterans Administration network, and the other demonstrations were also administered through existing programs. Presently existing entities--the Employment Service, Private Industry Councils/JTPA administration--could be used to administer a voucher program, but its administrative provisions, and paying for its costs, need have to be thought out carefully.

Conclusion. Voucher approaches have not been tried extensively in employment and training. However, there are lessons to be drawn for the voucher study conducted for the NCEP: (1) The proportion of disadvantaged persons who will take advantage of vouchered classroom training ranges between one-fifth and one-third, and better educated, younger, female, and more skilled eligibiles are more likely to participate in voucher programs; (2) Under the GI Bill, which was an entitlement, about three-fifths of those who were eligible took advantage of the program. The veterans using the GI Bill tended to be better educated males; (3) Counseling about training must take into account the skill levels of individual participants so that they can choose training for occupations in which they are likely to succeed in improving their employment and earnings; (4) Vouchers targeted solely on the disadvantaged for OJT or wage subsidies seem to be inappropriate and ineffective; and (5) Vouchers are not less expensive than traditional employment and training services since they require administrative, counseling, and support staffs and the longer training is more costly.

D. Targeted Economic Development Those persons with the most persistent unemployment problems are the displaced workers and disadvantaged workers. And there is a locational aspect to their problem. Generally those considered to be displaced workers are concentrated in certain basic industries--such as autos, steel, and related industries--that are concentrated in particular regions of the country. The disadvantaged, especially disadvantaged youth, tend to be concentrated in the greatest numbers in urban areas. The regional and urban focus of this unemployment suggests the need for forms of targeted economic development.

The return of employment opportunities to depressed regions and to central cities will depend upon the creation of new and different economic bases. Developing new and different bases, in turn, will depend upon a variety of factors: human resources, private capital, availability of land, and improvements in infrastructures (such as roads, bridges, and sewers).

Programs already exist that can promote new economic development. At the Federal level there are Community Development Block Grants, Urban Development Action Grants, Economic Development Administration programs, and various educational and training programs, among them the Job Training Partnership Act. Enterprise zones are another approach to stimulating private sector investment in economically distressed areas. This approach relies largely on tax incentives as a way to influence firms' locational decisions; some specific proposals also encourage linking the capital investment with incentives to train and hire the disadvantaged residents of a Zone. Linking training programs for the long-term unemployed with private sector capital is the most difficult aspect of economic development, according to a 1980 NCEP report on using economic development policies to reduce structural unemployment. The JTPA should be able to facilitate the needed linkages and provide an important part of the base for development. But the other programs, which stimulate the private sector investment are also needed to help bring about development.

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